

OFFICE OF
CONTROLLER

RICK TUTTLE
CONTROLLER

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November 23, 1994

INSTITUTE OF GOVERNMENTAL
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Mr. Randall Bacon, General Manager
Department of General Services
Room 800, City Hall East
Los Angeles, CA 90012

JAN 17 1995

UNIVERSITY OF CALIFORNIA

Dear Mr. Bacon:

Our Audit Division has completed an audit of Purchasing at the General Services Department for the period July 1, 1992 through March 31, 1994. The results of our audit along with recommendations to improve internal controls or streamline operations are discussed in the attached report.

Please have your staff review the report and respond to the Controller's Office within 30 days on actions taken to implement the recommendations contained therein. Should you so desire, our audit staff is available to discuss the contents of the report with you at your convenience.

The cooperation extended by your staff during the course of our audit activities is appreciated.

If you have any questions on this report, please call Mike Lee, Chief Auditor, at (213) 485-4525.

Very truly yours,

RICK TUTTLE, CONTROLLER

By *James P. Armstrong*
James P. Armstrong, CPA
Director of Auditing

JPA:AA:vca

Mr. Randall Bacon, General Manager
Department of General Services
November 23, 1994
Page Two

cc: Hon. Richard Riordan, Mayor
Hon. John Ferraro, President, City Council
Hon. Zev Yaroslavsky, Chairperson, Budget and Finance Committee
Hon. Joel Wachs, Chairperson, Governmental Efficiency Committee
Hon. Rudy Svorinich, Chairperson, Administrative Services Committee
William G. Ouchi, Chief of Staff, Mayor's Office
Michael Keeley, Deputy Mayor
J. Paul Brownridge, City Treasurer
Keith Comrie, City Administrative Officer
Ron Deaton, Chief Legislative Analyst
Independent City Auditors



GENERAL SERVICES DEPARTMENT

PURCHASING

I. EXECUTIVE SUMMARY

The Office of the City Controller is conducting an audit of the financial controls and related aspects of the General Services Department (GSD) for the period from July 1, 1991 to March 31, 1994.

In an effort to provide timely information to GSD management, we are issuing interim reports on completed audit activities. This report deals exclusively with the procurement process for materials, equipment, equipment rental and repairs for Council controlled Departments.

This report does not include a comparison of City Stores' prices versus retail prices for commonly used materials, supplies and equipment. We will issue a separate report when our analysis of prices is completed.

Section 391 of the City Charter grants authority for procurement to the Purchasing Agent of the City except for purchases requiring payment from the funds controlled by the Airport, Harbor, Library, and Water and Power Departments. Section 22.502 of the Administrative Code identifies the General Manager of the Department of General Services as the Purchasing Agent of the City.

Actual dollars expended for procurement awards by purchase authorities for the audit periods covered were as follows:

Expenditures for FY 91-92 and 92-93 (in millions)		
	FY 91-92	FY 92-93
Annual Contracts	\$152.9	\$164.9
Purchase Orders	30.5	19.5
MICLA	10.9	19.1
Blanket Purchase Orders	2.9	3.1
Petty Cash	.9	.8
TOTALS	\$198.1	\$207.4



Emergency Orders (Confirming Orders) of approximately \$3 million per year are included in the amount of Purchase Orders. Also included are One-Time Contracts amounting to \$17.8 million for FY 91-92 and \$6.3 million for FY 92-93. (see p.10)

Dollar figures were obtained from the Financial Management Information System (FMIS) and reflect payments made to vendors for the particular authorities. The schedule on page one does not include the City's expenditures for personal service and construction contracts. These types of contract services were procured directly by the user Departments and amounted to \$531 million for FY 91-92 and \$236 million for FY 92-93.

A. AUDIT OBJECTIVES

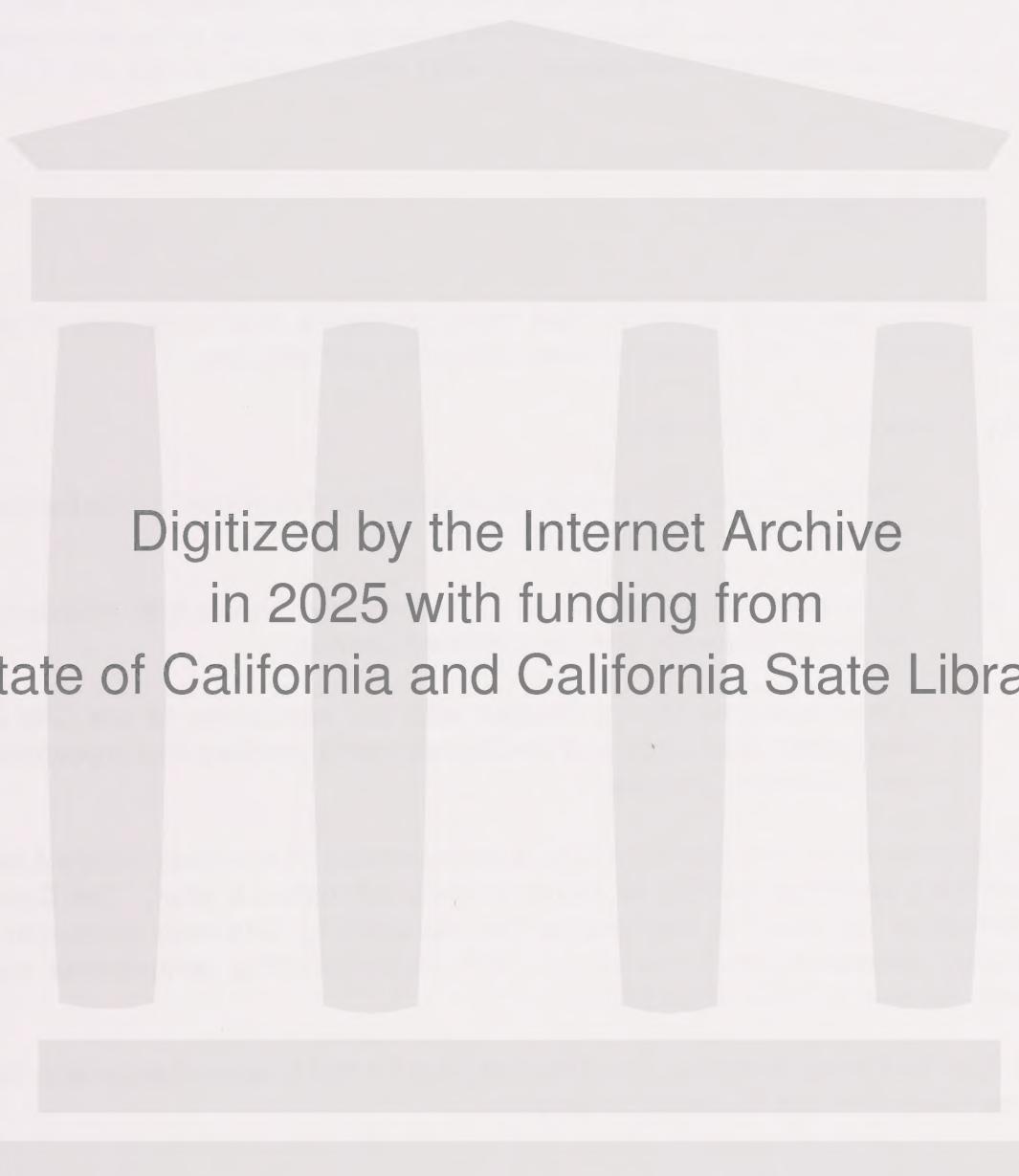
Our audit was designed to verify that the Department had a system of adequate internal controls and that controls were effective and efficient.

The objectives of the audit were:

1. To ensure that GSD procured materials and supplies for the best available prices;
2. To ensure that management implemented effective and efficient policies and procedures in the procurement process;
3. To ensure that GSD complied with the provisions of the City Charter, Administrative Code and the Department's policies and procedures in the procurement process.

We did not include in our audit the City's procurement of computer related hardware and software which amounted to approximately \$3 million a year. The Department of Information Services is responsible for establishing Citywide computer related technology standards and guidelines, and recommending appropriate computer products for use by City departments.

We did our field work between July 1993 and April 1994 in accordance with Generally Accepted Government Auditing Standards.



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B. AUDIT TECHNIQUES AND METHODOLOGY

To accomplish our objectives, we interviewed staff members of the Purchasing Division and reviewed pertinent sections in the City Charter, Administrative Code and Executive Directive 16. We obtained an understanding of the procurement process by reviewing the Procurement Manual and the Buyer's Manual prepared by GSD. We also examined and analyzed bid award folders and contracts.

We reviewed the following reports generated from the DB2 System, a data base downloaded from the Materials Management System:

- One-Time Purchase Order Awards to All Vendors
- Confirming Purchase Authorities
- Buyer/Award Statistics
- Blanket Purchase Orders Issued to Departments
- Buyer/Vendor Multiple Awards
- Vendors Awarded 3 or More Purchase Authorities
- Vendors Awarded 10 or More Purchase Authorities
- Annual Authority Amendments

We also analyzed the Overdue Notice Report for Purchase Orders (PO's) Over 60 Days Old, a monthly report generated by the City's FMIS.

As needed, we utilized information available in the Materials Management System. As part of our audit, we reviewed the status of prior audit recommendations contained in our report of February 14, 1989. The four recommendations in the area of Purchasing were partially implemented and are included in this report as part of Finding No. 1.

C. OPINIONS AND RECOMMENDATIONS

In our opinion, the General Services Department's internal controls for the purchasing function had material weaknesses. The Department's management did not have clear policies and direction to lead the City's purchasing function and was also burdened with outdated procedures and City rules and regulations. As a result, purchasing functions are limited to processing paperwork. Procurement decisions are often made without proper planning, contract and price analysis, and demand analysis. The Department's management should streamline the paperwork process and enhance the market research function.

The overall magnitude of inefficiency and ineffectiveness was not quantified because of the many variables in the City's procurement process.



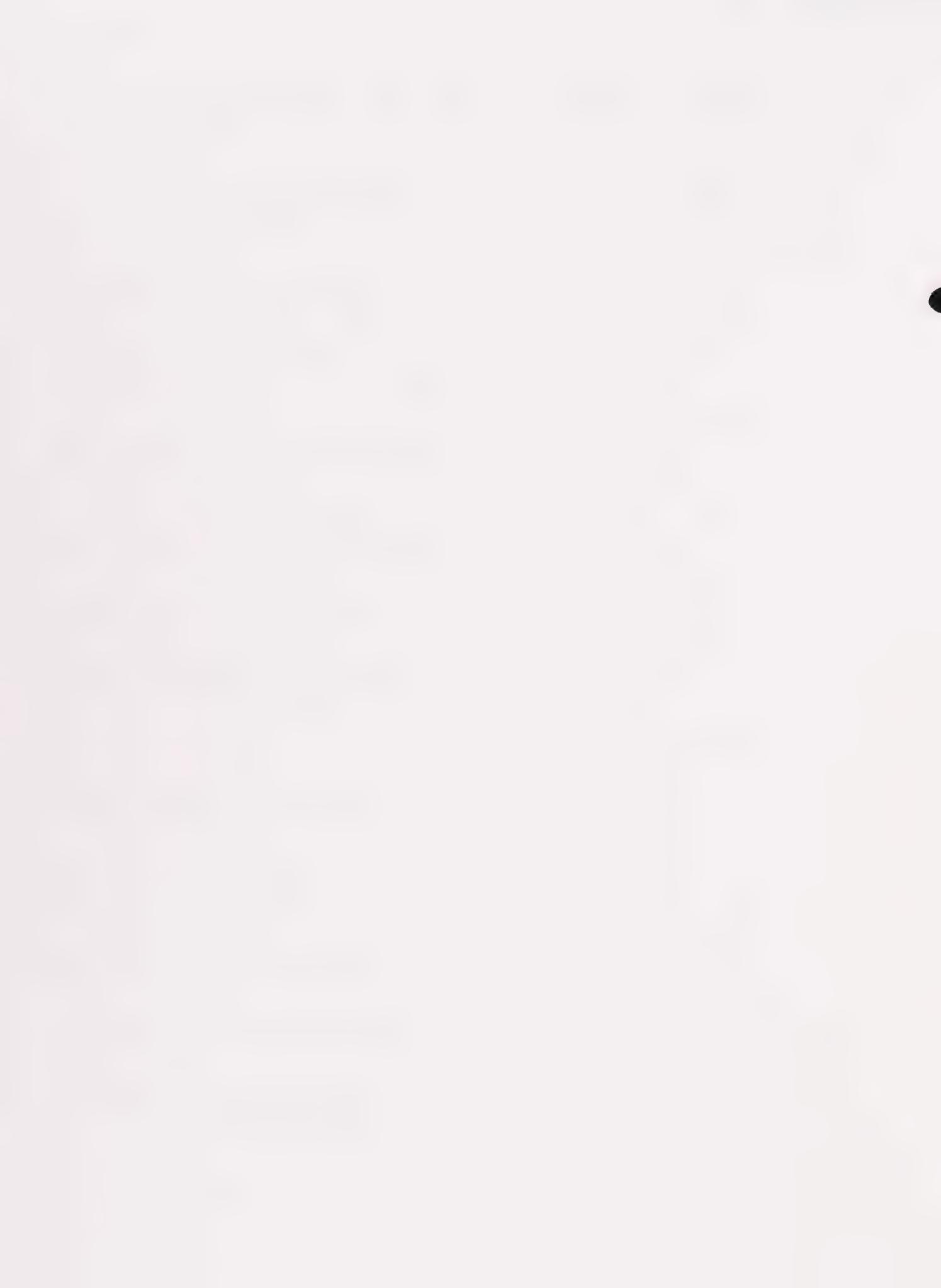
Our recommendations require strong management commitment and immediate action.

We recommend that the Purchasing Division:

1. Strengthen Vendor Performance Review and Market Research Functions.

A. Vendor Performance

- Provide and implement clear Citywide policy and written guidelines for evaluating vendor performance.
- Develop a program to monitor the performance of vendors for key materials with high volume.
- Evaluate and enter vendor performance ratings in the Materials Management Systems so that the vendor file will accurately reflect true vendor performance.
- Update vendor lists based on current ratings, eliminating vendors with consistently poor ratings.
- Use vendor ratings when selecting vendors for invitation to bid.
- Clearly define a non-performing vendor. Establish Citywide policy and written guidelines to deal with non-performing vendors. Enforce the policy against non-performing vendors.
- Demand performance such as:
 - ✓ Develop clear written policy and guidelines to require performance bonds and enforce forfeiting the bonds for failure to deliver,
 - ✓ Document the reasons for waiving the performance bond when they are waived,
 - ✓ Incorporate a penalty clause for non-performance in contracts,
 - ✓ Delete non-performing vendors from the vendor list and disqualify them from future bids.
- Institute a policy to rotate buyers, clearly stating the reasons why this is necessary and how this is to be implemented.

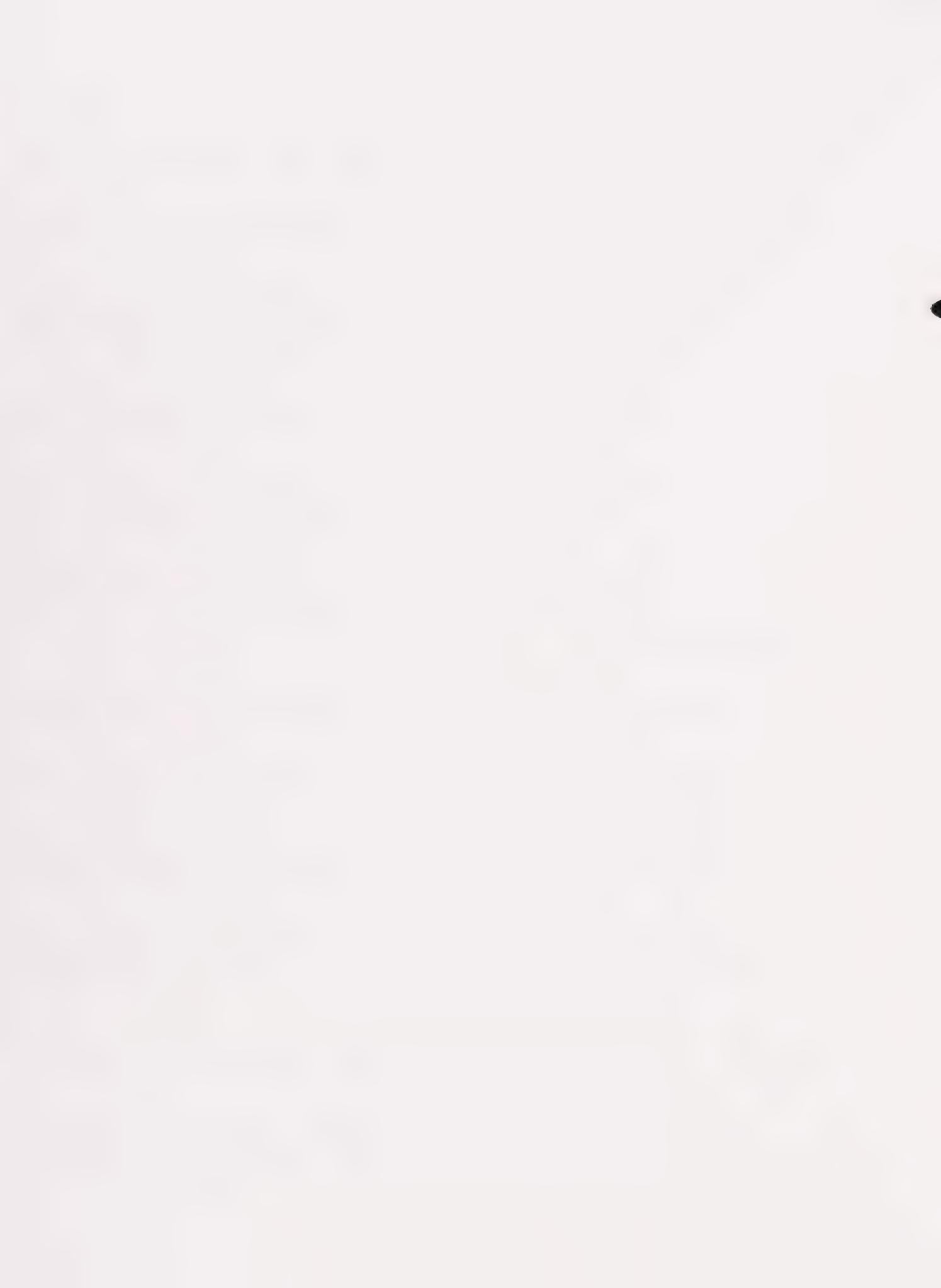


B. Contract and Price Analysis

- Conduct contract and price analysis on an ongoing basis to ensure the City gets the best available prices.
- Include a clause for price decreases in the standard contract language.
- Stay current on price trends in the market by establishing on-line access to commodity prices such as Data Resources that provides price forecasting and historical data of commodity prices.
- Analyze specification requirements and price differences among different brands and specifications when comparing commodity prices.
- Study and utilize contracts of other government agencies such as the County, State, and the Department of Water and Power.
- Utilize multiple vendor contracts to ensure that the City is not stuck with buying from just one vendor, who may not have the product when it is needed or may ask for a higher price.

2. Emergency Purchases

- Assume the responsibility to monitor the emergency Purchase Orders (PO's) as part of enhancing the overall procurement process.
- Plan and coordinate with the user departments in order to maintain an ongoing contract or purchase through a PO with competitive prices.
- Clearly define the nature of emergency; Communicate with the user departments to ensure that they have a clear understanding of what an emergency is and the requirements for an emergency PO.
- Implement the review of required Emergency PO documents and enforce the guidelines set in the Procurement Manual and/or Buyer's Training Manual.
 - ✓ Enforce the 10-day delivery requirement.
 - ✓ Enforce the Mandatory Requirement for Emergency Purchase Order forms to be approved by department head.
 - ✓ Have employee(s) who failed to prepare the confirming order 10 days after receiving the Emergency Purchase Order number personally liable for the purchase as specified in the Procurement Manual.



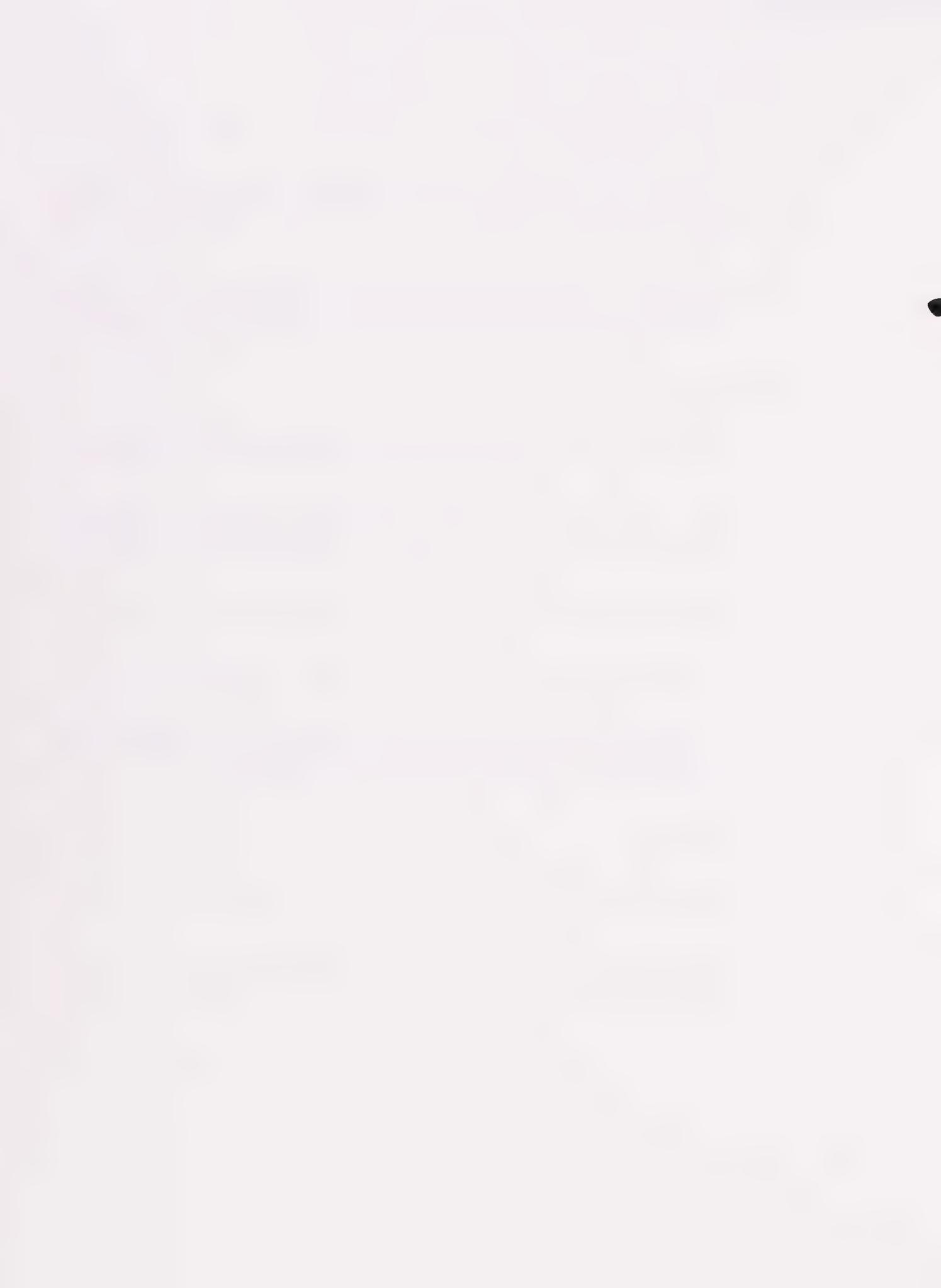
- ✓ Process cancellation of Emergency PO's once the request is submitted.
- Require three competitive bids as specified in the Buyers Training Manual, or revise the policy if the bids are not practical for Emergency PO's.
- Disallow the issuance of Emergency PO's to the same vendor on the same day, which is often intended to circumvent the City's bid requirement for advertisement and formal competitive bidding process.

3. Contract Amendments

- Develop a periodic report which provides management with a listing of change orders with dollar amounts.
- Hold planning sessions with departments and develop Citywide procedures to systematically estimate the demand for key materials and supplies.
- Reflect quantity and volume estimates in original contract bid and award process.
- Develop and institute quantity and volume discount clauses in contracts.
- Coordinate with the Controllers Office to monitor and identify contract expenditures exceeding the original estimated amount by 100 percent or \$100,000 in compliance with Executive Directive 16.

4. Minor Purchases

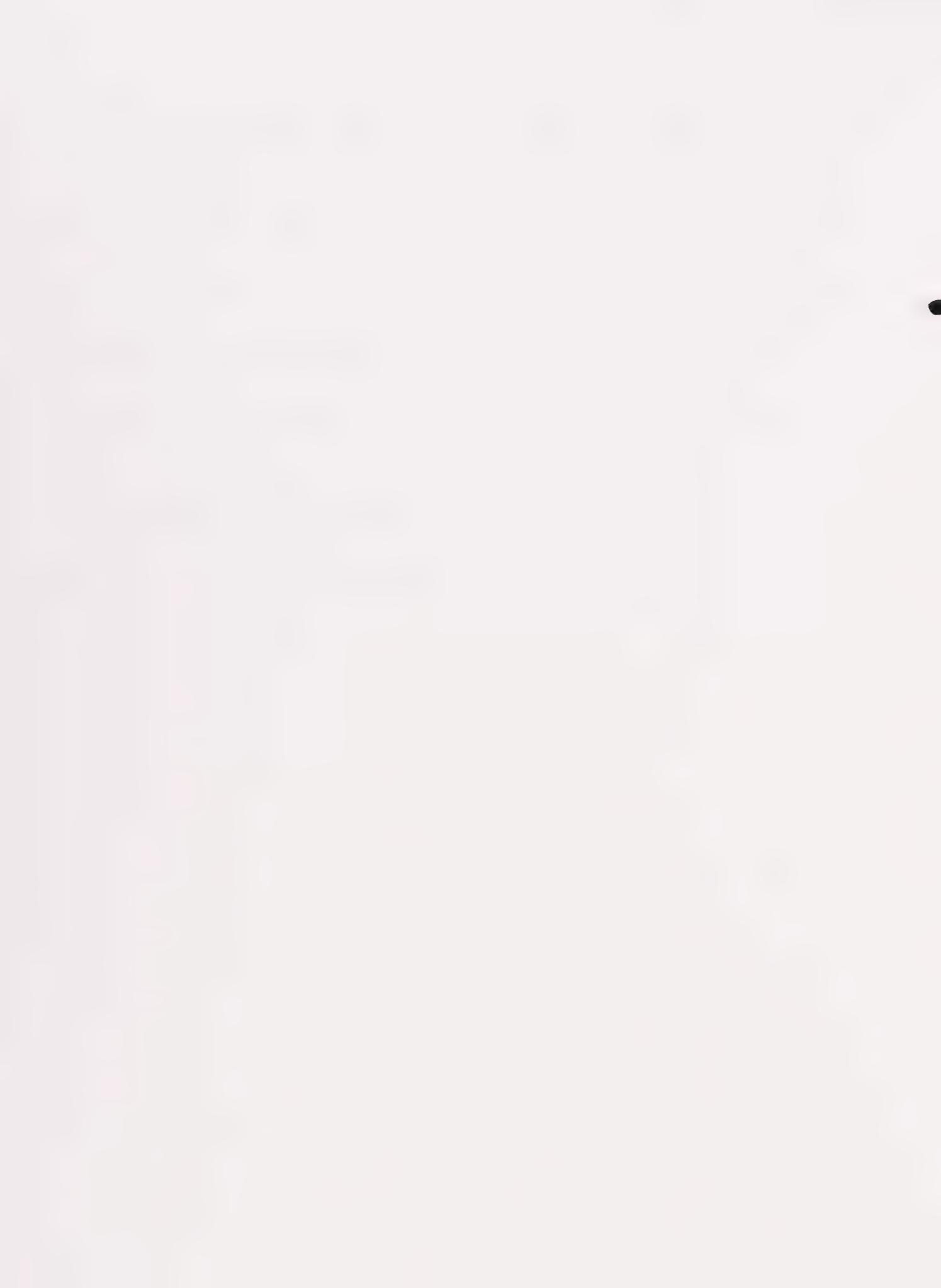
- Eliminate the emergency provision for using Blanket PO's to allow their use in routine purchases.
- Increase the Blanket Sub-Purchase Orders (Sub-PO's) to \$500 or \$1,000 in order to procure minor purchases with Blanket Sub-PO's instead of Purchase Orders.



- Analyze and evaluate the criteria for the City's bid and procurement requirements to determine the effectiveness and propose changes to the Council.
- Allow for negotiation of price for small purchases when such negotiation is in the best interest of the City.

5. Outstanding Purchase Orders

- Develop a system for monitoring open PO's with the objective of tracking down late delivery by vendors.
- Coordinate with the Controller's Office and analyze the "Purchase Order Overdue Notice Report."
- Coordinate with user departments to evaluate on-time delivery performance of vendors and show in vendor's performance rating.
- Work with Departments to identify past-due delivery items and encourage cancellation of these Purchase Orders.



II. BACKGROUND

The Purchasing Division of the Department of General Services is responsible for:

- ☒ the procurement of materials, supplies, services, equipment and rentals for Council controlled departments and agencies;
- ☒ the establishment of standards for materials and equipment used by the City except for computer equipment;
- ☒ the administration of the City's Affirmative Action, Small Local Business (SLB), Minority Business/ Women Business Enterprise (MBE/WBE), Material Safety Data sheets (MSDS), Child Care Declaration Statement and Employment and Training Policy programs as related to procurement; and
- ☒ the maintenance of a vendor data base for Council-controlled City Departments.

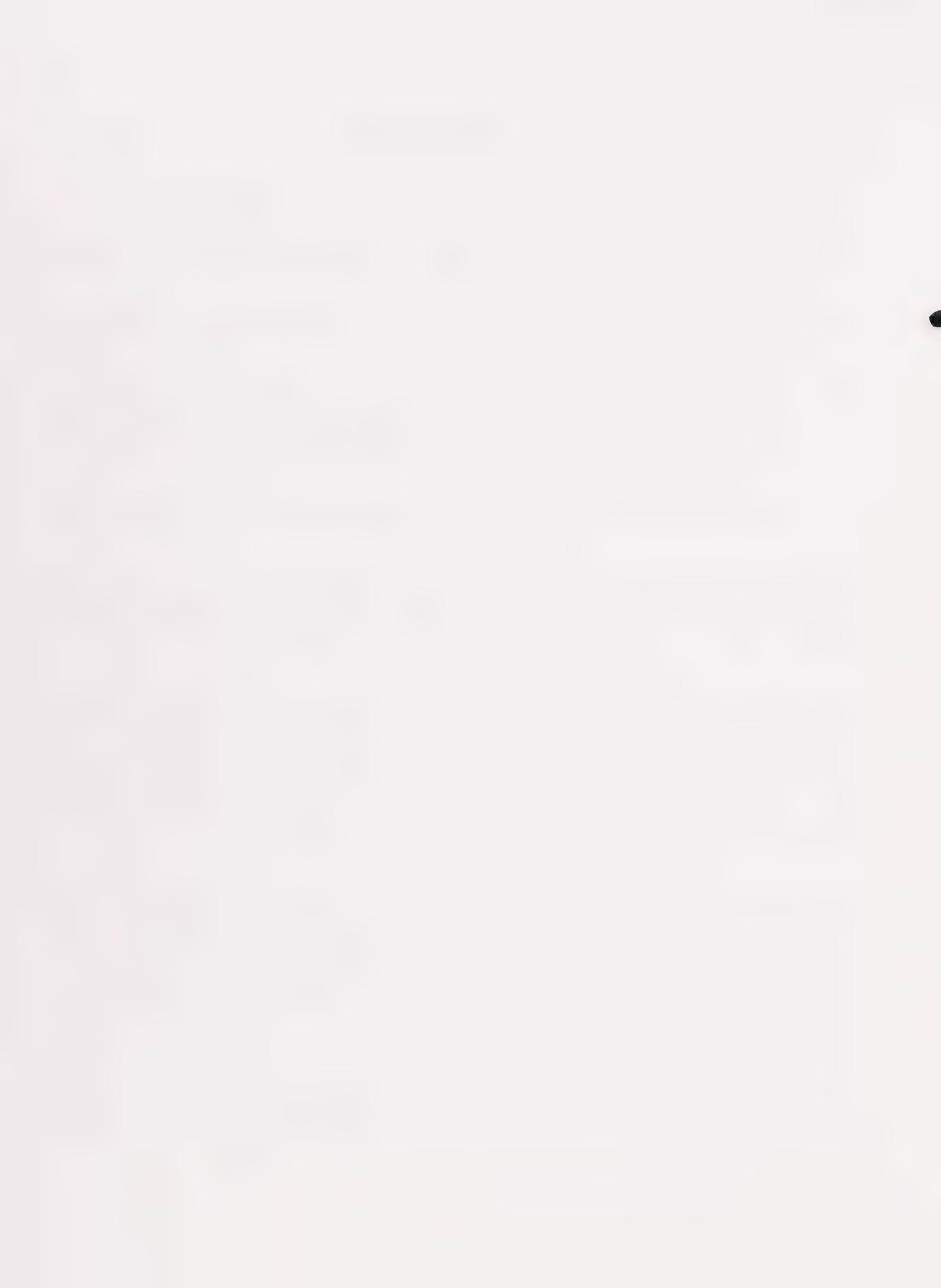
The Purchasing Division is comprised of four sections: Procurement, Technical Support Services, Administrative Support Services, and effective July 1993 the Market Research. Prior to July 1993, the Division did not have the Market Research Section.

The Procurement Section is currently comprised of ten Buyers and seven Senior Buyers divided into four commodity groups. It is headed by one of the two Directors of Purchasing who reports to the Director of Supplies, who is the head of the Purchasing Division. The section processes purchase requisitions from departments, authorizes annual contracts to be utilized for the materials and services on a repetitive basis, and issues Purchase Orders for one-time purchases. In addition, the Section solicits bids from vendors and awards purchase authorities.

The Technical Support Section is responsible for the preparation of specifications and recommendation of standards of quality for City equipment and supplies for the City Purchasing Committee. The Section also reviews department requests for deviation from standard specifications, revises existing standard specifications, and implements the Recycling Ordinance of the City. The Section is headed by a Purchasing Specifications Analyst, and staffed by an Equipment specialist, a Senior Buyer and a clerk typist.

The Market Research Section is responsible for conducting research on product quality and pricing to ensure that the City is paying the lowest possible price for the quality of items purchased. At the time of our audit, the Section was developing procedures to monitor the following vendor performance on annual contracts:

- ✓ the timeliness of delivery,



- ✓ the quality of goods,
- ✓ the accuracy of quantity,
- ✓ the accuracy of billing, and
- ✓ vendor attitude.

The Section also compares prices paid by the City with prices paid by the State, County and other governmental agencies for similar items. The Section is headed by a Senior Buyer and staffed by two Buyers and one clerical employee.

The Administrative Support Services Section is responsible for coordinating various administrative support functions for the Purchasing Division, including personnel, budget, training, inventory, overtime monitoring, management report writing, and special projects. The Section is headed by a senior management analyst and staffed by two management analysts and a senior clerk typist. The Section also has a chief clerk who supervises a senior clerk and four clerk typists.

LEVELS OF AUTHORITY

The Purchasing Division assigns the following levels of authority to sign annual contracts and Purchase Orders.

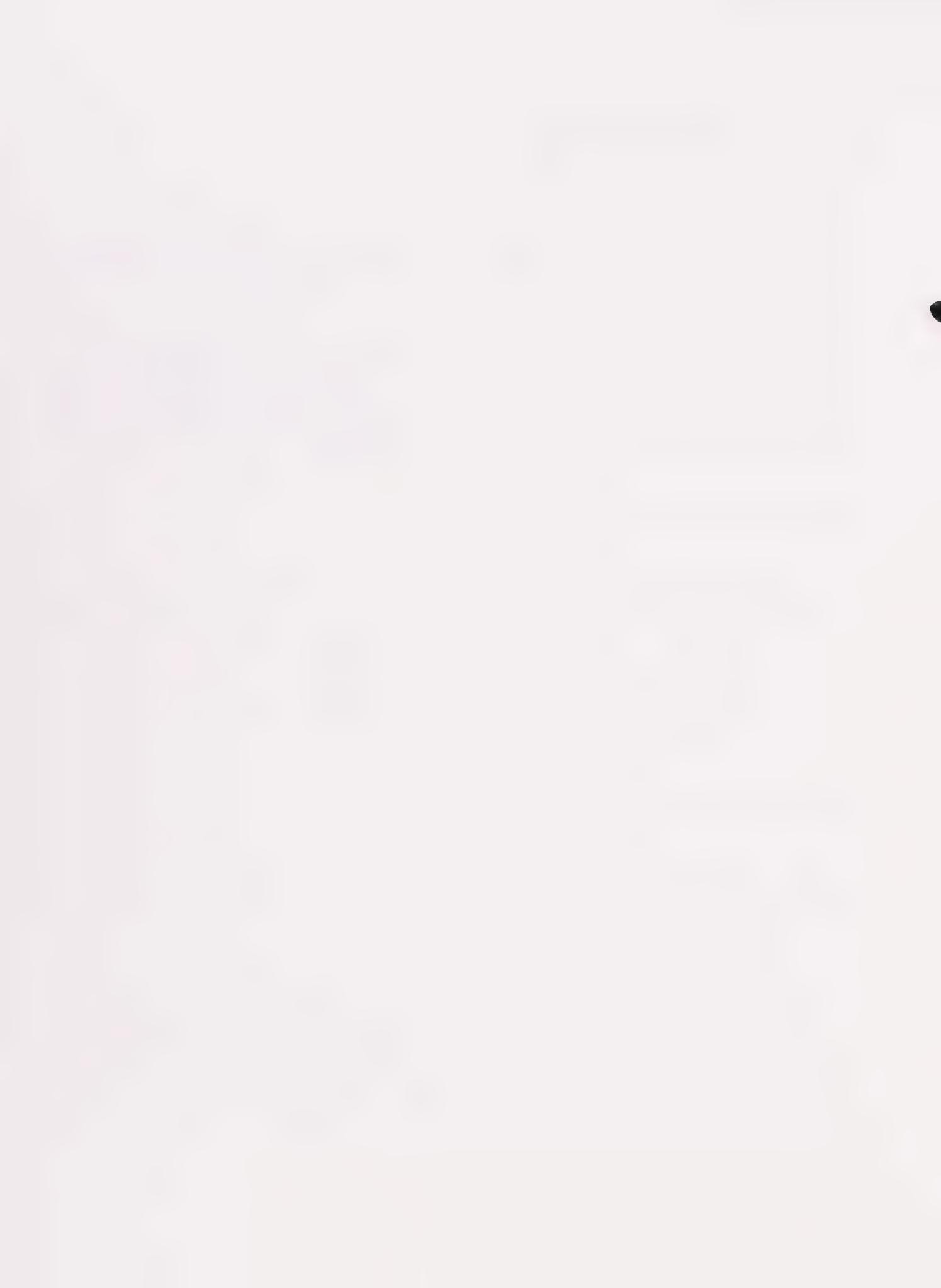
-	Buyer II	up to \$ 50,000
-	Senior Buyer	up to \$100,000
-	Director of Purchasing	up to \$100,000
-	Director of Supplies, & Assistant General Manager	over \$100,000

PURCHASING AUTHORITIES

Buyers negotiate contracts and bind the City through the following purchasing authorities:

- **Annual Contracts**

A legally binding agreement awarded by the Purchasing Agent for repetitive purchases of materials or services from a specific vendor under specific terms and conditions. An annual contract provides a price agreement for procurement of supplies, materials or services. The agreement may be renewed annually up to four years, totaling five years maximum. Contracts are utilized by the departments through the use of Sub-Purchase Orders.



- **Purchase Orders**

A written authorization awarded by the Purchasing Agent in response to a Purchase Requisition submitted by a department and calling on a vendor to furnish goods or services for a one time purchase only and not available in an annual contract. Purchase Orders with amounts over \$100,000 are One-Time Contracts.

- **Emergency Orders (Confirming Orders)**

An emergency authorization requested by the departments to procure goods when the items are not available in City Stores, there are no existing contracts, and an emergency requires that the goods be provided immediately. Confirming orders must be telephonically approved by the Purchasing Division prior to placing the order, except in extreme emergencies which occur when the Purchasing Division is not operational and the purchase is approved by a supervisor.

- **Blanket Purchase Orders**

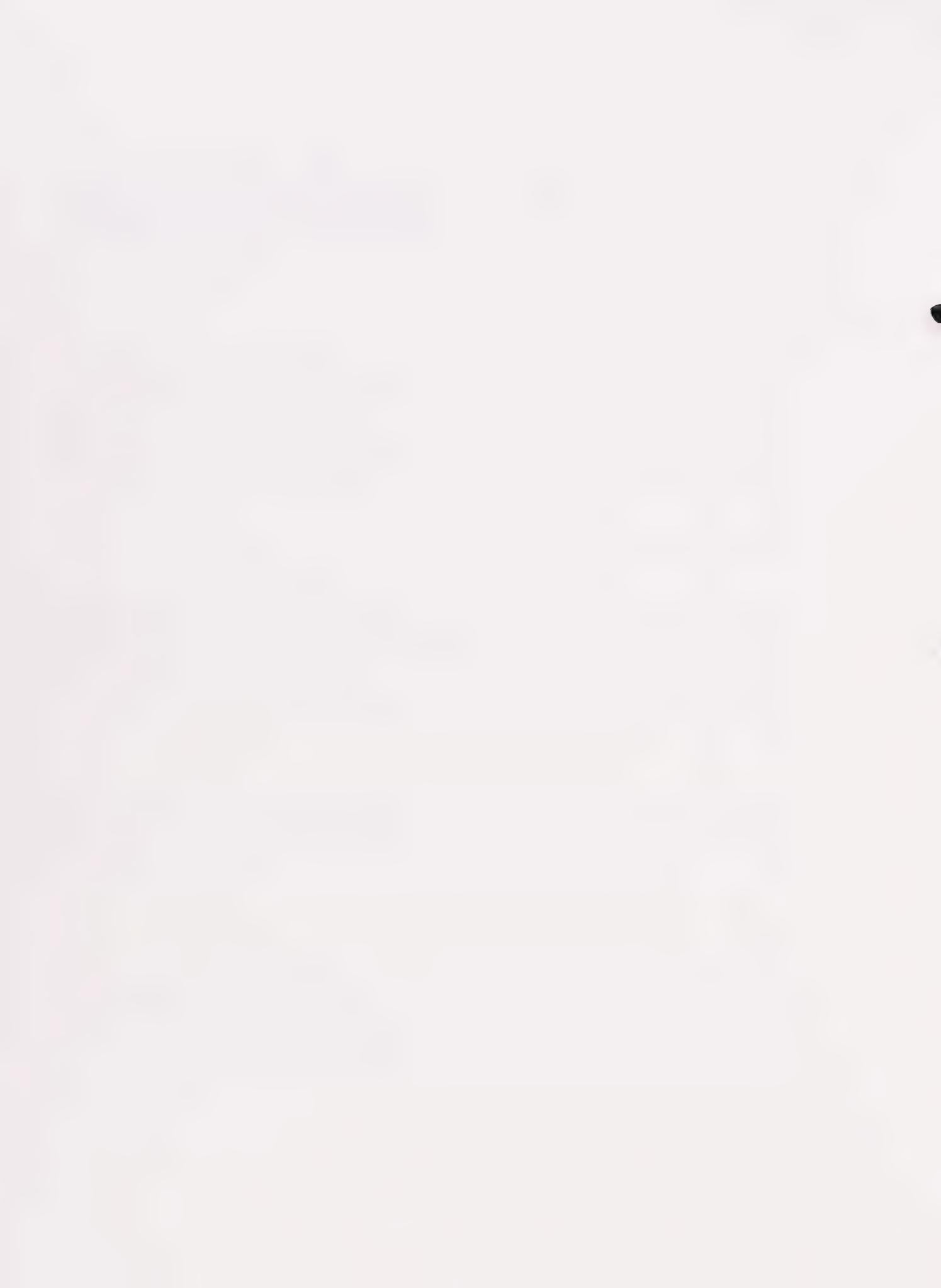
An authority provided on an annual basis to departments to make limited emergency purchases for miscellaneous repairs and supplies not carried in City Stores' stock. It specifies no particular items to be purchased and is awarded to no particular vendors. Sub-Purchase Orders against the blanket orders are limited to a maximum of \$200 for any single purchase not to exceed \$20,000 per month per account for any calendar month.

- **Petty Cash**

An Annual Blanket Purchase Order authorized by the Purchasing Agent against which departments obtain cash to reimburse employees for legitimate emergency purchases not to exceed \$100, exclusive of sales tax, for any one item.

- **MICLA**

Municipal Improvement Corporation of Los Angeles purchases are for the acquisition of properties and equipment, for the construction of buildings, for the development of systems and other improvements for the benefit of City residents. These are leased to the City under long-term lease agreements and become the property of the City at the termination of the lease.



THE PROCUREMENT PROCESS AND LEGAL REQUIREMENTS

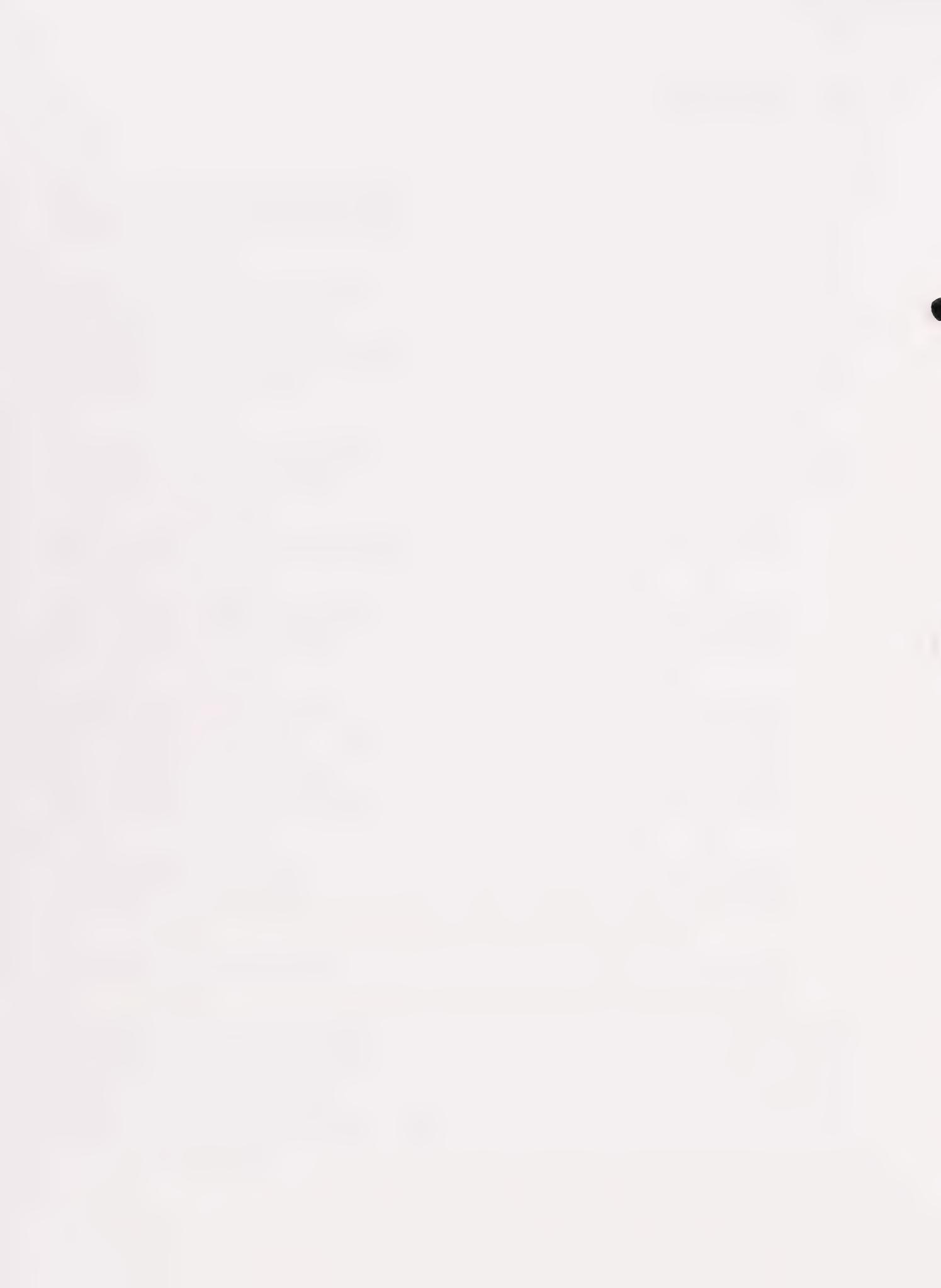
Departments may obtain common items stocked in City Stores through the use of the Stores Multi-Use form. Items not stocked in City Stores may currently be obtained through petty cash or purchased by Sub-Purchase Orders for emergency situations.

Materials not stocked in City Stores may also be obtained through annual contracts or one time Purchase Orders. The Purchasing Division provides copies of the contracts and listings to all accounting sections of departments which are authorized to utilize these contracts. The items are purchased through the use of a Sub-Purchase Order against the annual contract. For items not on annual contracts or for a one time buy, the Purchasing Agent issues Purchase Orders.

All purchases including emergency purchases, are subject to competitive bidding. Bid requirements for Annual contracts and Purchase Orders are categorized by amount as follows:

- For amounts **up to \$500**, bids need not be written and may be made via the telephone. At least three quotes are required.
- For amounts **over \$500 up to \$5,000**, informal written bids are required. Vendors are also required to provide an Affirmative Action Statement to comply with Administrative Code Section 10.8.3.
- For amounts **over \$5,000 up to \$25,000**, informal written bids are also required as an instrument for competitive bidding except for extreme emergencies. All bid documents for purchases in excess of \$5,000 must have an approved and valid Affirmative Action Program per Administrative Code Section 10.8.4. Both annual contracts and one-time buys are represented in this range. These do not require public advertising as provided by the City Charter.
- For amounts **above \$25,000**, public advertising is required as provided by City Charter Section 386 (c). These are formal written bids and may be either for Purchase Orders or annual contracts.
- For contracts **over \$100,000**, City Attorney's approval as to form is required per Administrative Code Section 9.5.

A Buyer's authority to purchase materials, supplies, equipment, rentals or repairs, and maintenance services is an electronically generated Purchase Requisition (City Charter Section 391). The Buyer puts out invitations to selected vendors and the returned bids are analyzed by the Buyer. The bid recap sheets along with the Buyer's recommendation are sent to the requesting department for review and final selection. The Purchasing Division issues the Purchase Order or awards the contract.



The Purchase Order (PO) is then sent to the Controller's Office for encumbrance. The Purchasing Division sends the PO to the vendor and the Receiving Report copy of the PO to the requisitioning department. The requisitioning department receives the goods, signs the Receiving Report copy of the PO for proof of delivery, and verifies the copy and invoices. The Department prepares the Payment Voucher and sends to the Controller's Office, together with the Receiving Report copy of the PO, invoice and/or packing slip for processing a payment.

Subsequent to the audit period, effective July 1, 1994, the Departments receive their copy of the approved purchase order from the Purchasing Agent through MMS and the FMIS system automatically encumbers the Purchase Order through an MMS interface to FMIS.

OTHER LEGAL REQUIREMENTS

- **ADVERTISEMENT**

All bids in excess of \$25,000 are required by City Charter Section 386 (c) to be advertised in a daily newspaper. However, it is the policy of the Purchasing Agent to advertise all bids for purchasing authorities for \$20,000 and up.

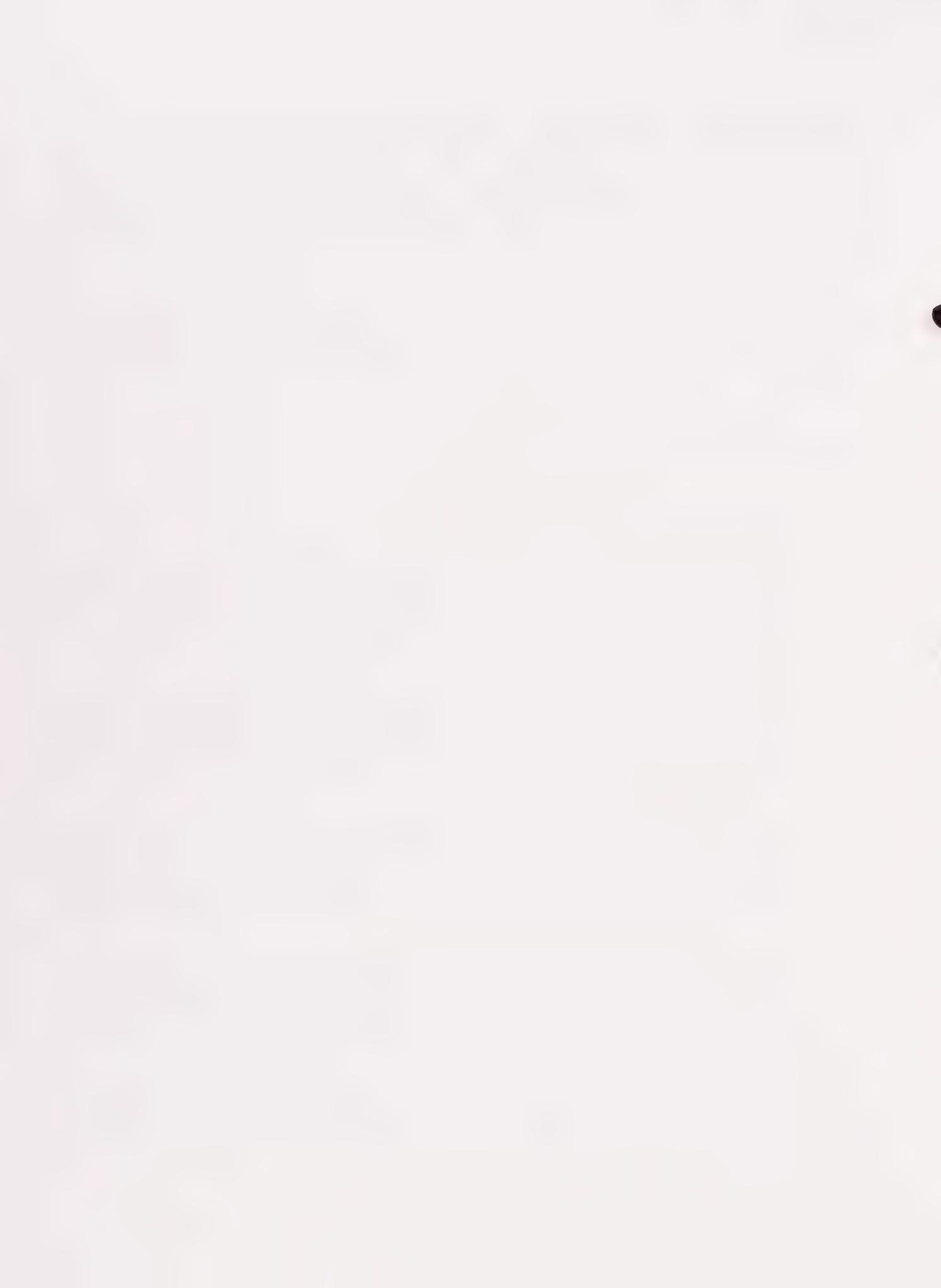
- **EQUAL EMPLOYMENT AND AFFIRMATIVE ACTION PROGRAM**

All bids over \$500 but not over \$5,000 must be accompanied by a signed certification of adherence to non-discrimination and Equal Employment Practices, and a completed Equal Employment Opportunity Officer Appointment form.

All bids over \$5,000 must be accompanied by the above items plus a completed Ethnic Composition of Total Work Force Report and a signed Affirmative Action Plan. The plan could be the City's approved plan that requires only signature of acceptance along with the ethnic composition of total work force and submittal to be effective.

When a vendor submits an Affirmative Action Plan of its own, the plan must be approved by the Office of Contract Compliance in the Department of Public Works. Approved plans are valid for one year from the date of City approval, at which time requests for renewal information are requested.

The same documents must be submitted for vendors' subcontractors and suppliers who furnish over \$5,000 of any contract awarded by the City. The bidder shall be responsible for obtaining the Affirmative Action Plan from its suppliers.



- **PERFORMANCE BOND**

This bond is a guarantee that a bidder who has been awarded a contract will fulfill all the obligations contained in the contract. It is usually required on public construction projects in excess of \$25,000, when something is uniquely designed and manufactured, when delivery schedules are critical or when assurance of product availability is needed. A performance bond is usually for 15% of the value of the contract and must be approved by the Insurance and Bond Section of the City Attorney's Office. Performance Bonds may be waived by the Purchasing Agent.

- **LABOR AND MATERIAL PAYMENT BOND**

This bond is required on construction contracts to guarantee that all subcontractors will be paid for all labor and material costs in case the contractor becomes insolvent and is unable to pay the subcontractors.

- **BID BONDS**

This bond is used on formal contracts of \$100,000 and over and requires a bidder to guarantee the bid if awarded a contract.

- **MINORITY BUSINESS ENTERPRISE/ WOMEN BUSINESS ENTERPRISE**

Bidders on City contracts over \$100,000 are required to provide a good faith effort to subcontract or engage in a joint venture with MBE and WBE and other local businesses. The goal of 12% of all awards to MBE/WBE was set for fiscal year 92-93.

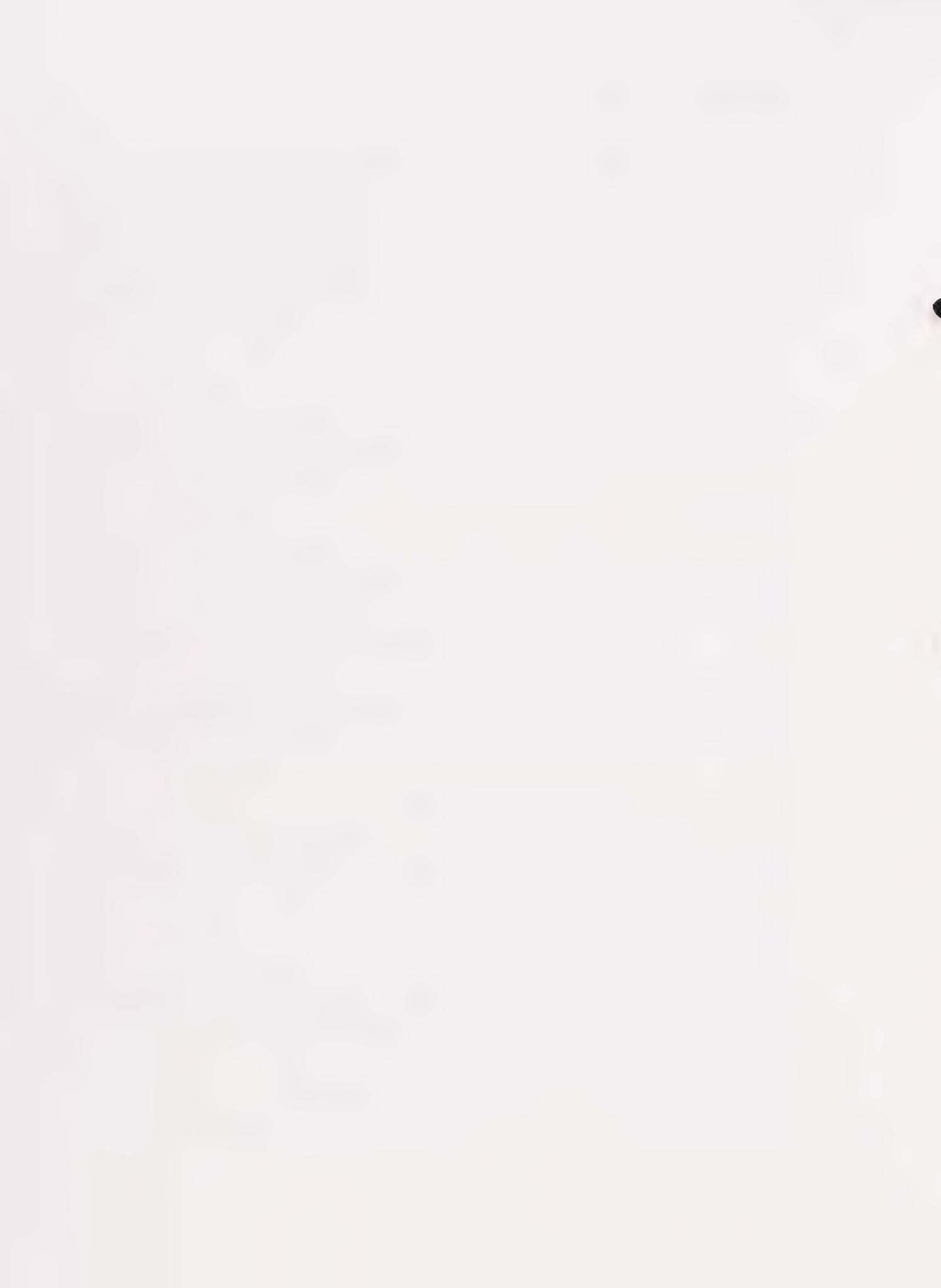
- **MATERIAL SAFETY DATA SHEETS (MSDS)**

Vendors are required by law to submit an MSDS with each purchase of a material which contains chemicals, cleaners, waxes, solvents, hand soaps, or any other item which may contain hazardous chemicals.

- **SMALL LOCAL BUSINESS PROGRAM (SLB)**

Applies to small businesses with principal offices located in the County of Los Angeles. This provides a 5% bidding preference on purchases up to \$25,000 to small local businesses with annual receipts as defined:

non-manufacturing	\$1M (previous fiscal year)
manufacturing	\$2M (previous fiscal year)
construction	\$3M (aggregate three previous fiscal year)



- **JOB TRAINING PARTNERSHIP ACT (JTPA)**

Bidders with City contracts over \$500,000 are required to submit a declaration regarding JTPA opportunities within their business organization.

- **CHILD CARE POLICY**

Vendors with stated child care policies shall receive preference in contracting with the City when vendors offer the same price for the same goods and the contract is for less than \$25,000.

- **RECYCLED PRODUCTS PURCHASING PROGRAM**

Where the cost of purchasing recycled products do not exceed 10% of the cost of non-recycled products, preference is given to recycled products for purchases over \$500.

BID AND AWARD PROCESS

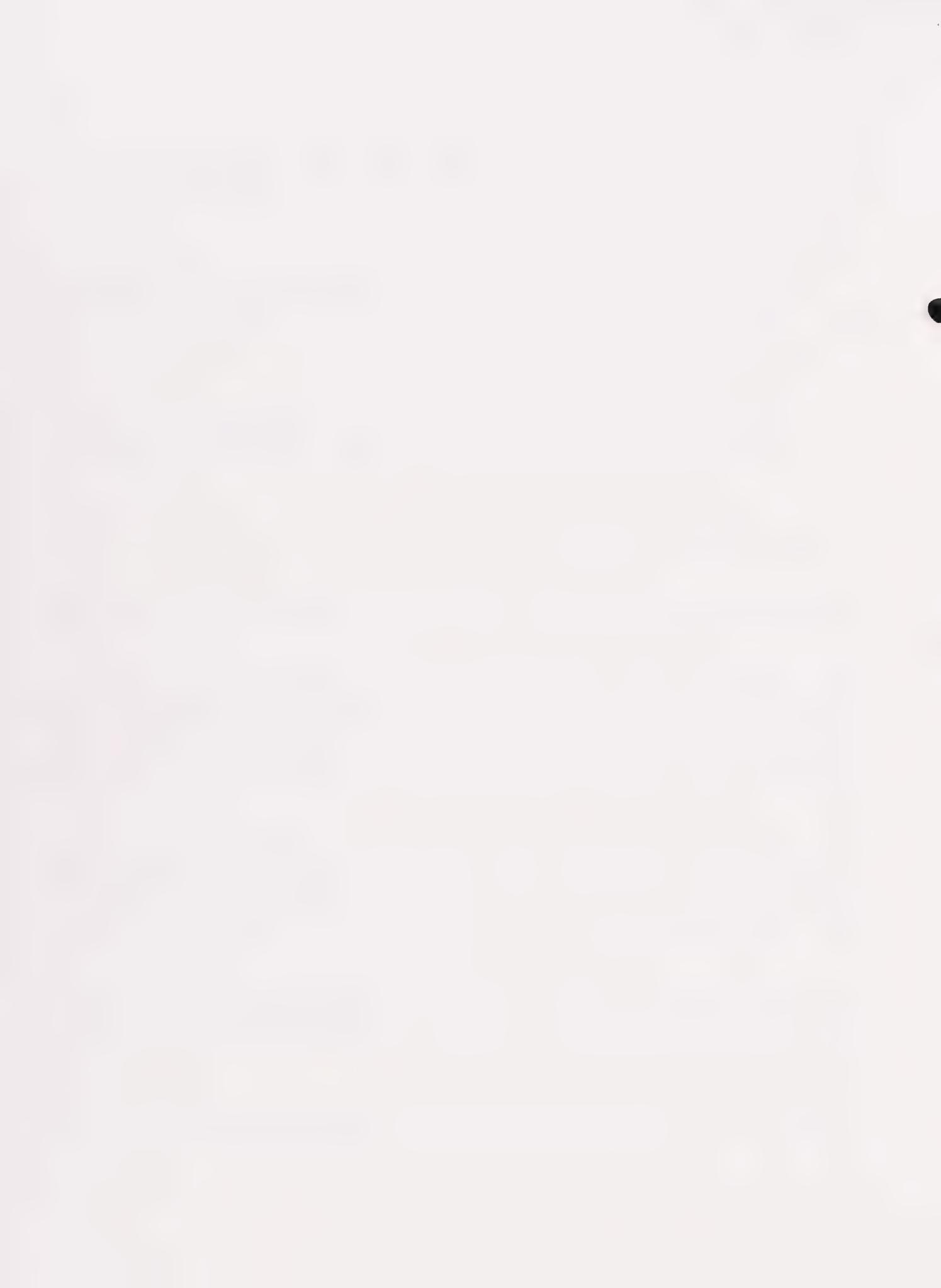
Competitive bidding is the primary method of public purchasing and is required per City Charter Section 386.

After completion of the Request For Bid, the Buyer selects the prospective bidders from the vendor list for the particular commodity code. To be included in the vendor data base, interested vendors must submit a completed Bidders Mailing List Application. Selection of bidders is based on the Buyer's familiarity with the vendors, suggestions from other Buyers and user department, vendors ability to respond to other previous bids, etc.

The Purchasing Division advertises all bids over \$20,000 in the Los Angeles Daily Journal and other publications, and on the City's Cable Channel. Available bid information is also posted at the front counter of the Purchasing Office in City Hall East. Most advertised bids allow 21 days for bidding and sealed bids are kept in the vault until the bid open date.

All advertised bids over \$20,000 are publicly opened and read by the Senior Buyer. All interested vendors are invited to attend the public bid opening. The bid recap sheet is generated and the bids are evaluated. After the bids have been opened, the City has three months to make an award.

After the buyer has evaluated the bids for completeness, bid copies may be transmitted to the requisitioning department for a recommendation of award.



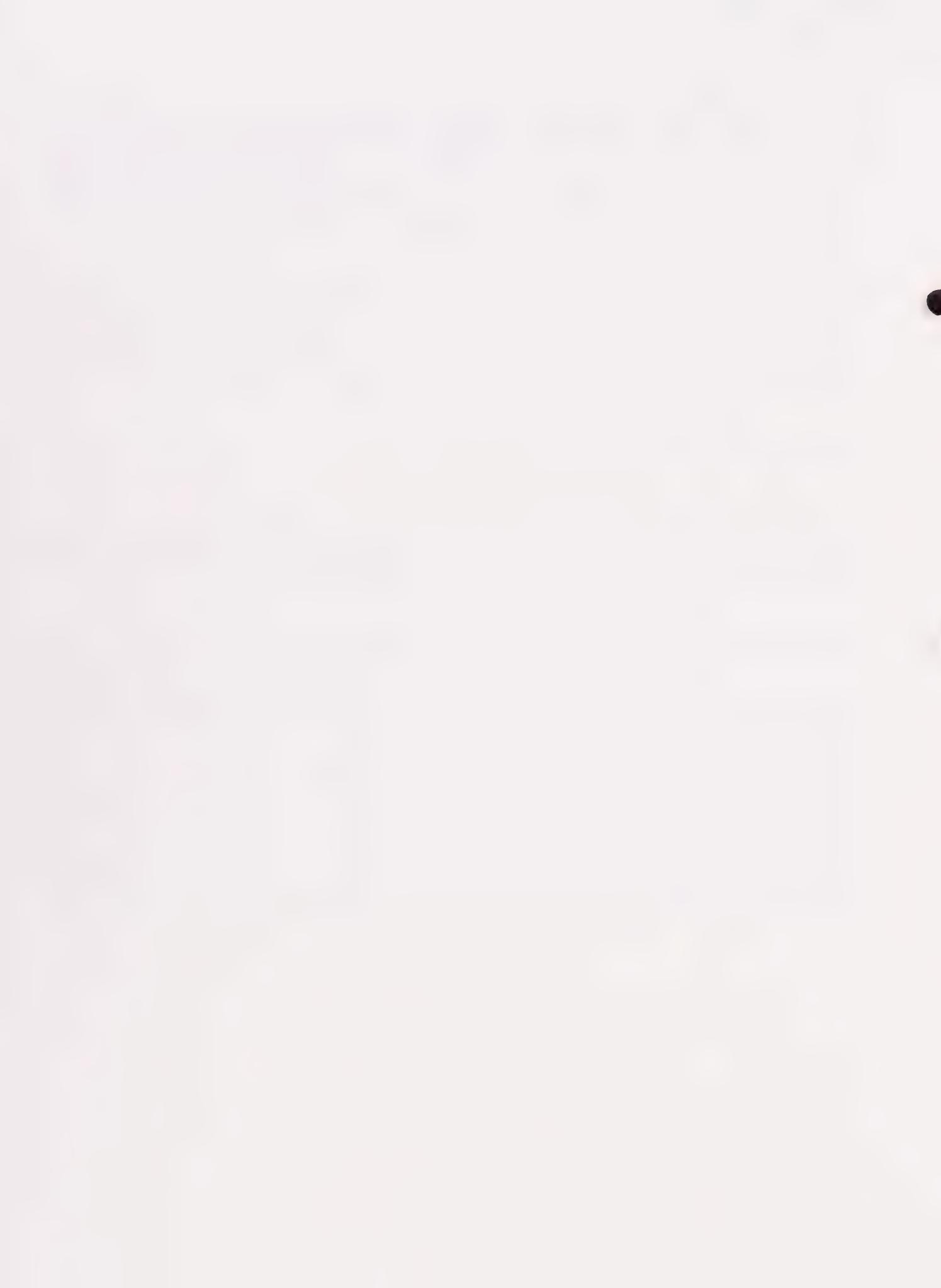
The bid copy file is returned to the buyer with a recommendation. The criteria is to award the bid to the lowest bidder complying with the specifications. Typical reasons for awarding to other than the lowest bidder are: product does not comply with specifications and the deviation is considered material; product does not comply with quality standards of the specified brand and the deviation is considered material; product will not result in the lowest ultimate cost to the Department.

The file then goes to the Director of Purchasing for approval if the award is in excess of \$100,000. The City Attorney's approval as to form is also required. Finally, the Notice of Award is mailed to the successful bidder. Within 30 days after the contract is awarded, the successful bidder is to execute the contract and post the performance bond when required. The contract may be for a period of one year, renewable for four years annually and not to exceed a total of five years.

WORK STATISTICS

A comparison of the volume of purchase requisitions received, bids sent out and the number of contracts and purchase orders issued during Fiscal Years 1991-1992 and 1992-93, as provided by the Purchasing Division, is presented below.

AUTHORITIES	FY 91-92	FY 92-93	%INCREASE (DECREASE)
Purchase Requisitions Received	7,196	7,894	9.7
Informal Bids Sent Out (< \$20,000)	2,348	1,843	(21.5)
Formal Bids (= > \$20,000)	820	624	(23.9)
Purchase Orders Issued	5,999	5,013	(16.4)
Emergency Orders (Confirming Orders)	1,264	1,180	(6.6)
New Annual Contracts	831	926	10.3
Renewed Annual Contracts	975	1,036	6.3
MICLA Contracts	122	127	4.1



III. FINDINGS AND RECOMMENDATIONS

This section of the report describes the individual findings and recommendations as a result of our audit.

FINDING NO. 1

The Division lacked clear overall policies and direction to ensure an efficient and effective procurement process.

A. The existing vendor performance evaluation was based on user departments' complaints about poor vendor performance. The Purchasing Division did not have a systematic process to evaluate vendor performance for key materials with high volume. In addition, there were no comprehensive policies or clear standard guidelines to enforce vendor performance.

The Purchasing Division maintained a list of 10,222 vendors and their products or services as of June 30, 1993 for the mailing of requests for bids. During fiscal year 92-93, 1,424 new vendors were added and 451 were inactivated. Addition is based on requests by vendors to be added to the list. Vendors are inactivated from a particular commodity code but not removed from the vendor list. Some reasons why vendors were inactivated included: no activity in a year; no response for at least three bids; no current address; a request from the vendor; judgement by a vendor performance review hearing.

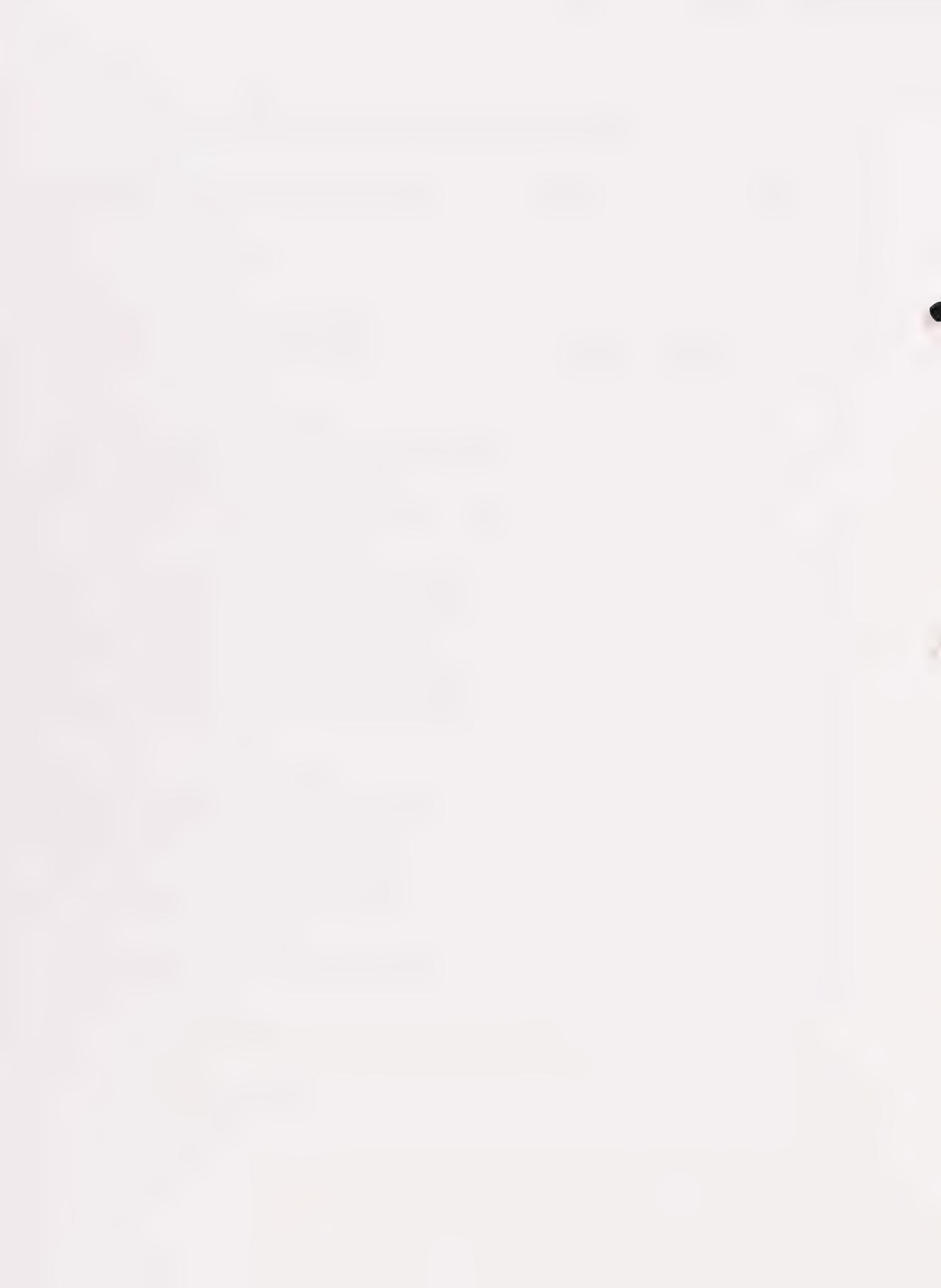
In June 1991, the Purchasing Division sent a letter instructing the heads of all City departments to issue a "Breach of Contract Warning Letter" to vendors who may be in violation of the terms and conditions of their contract with the City. This form letter was intended to place a vendor on notice and document the specifics of a vendor's poor performance. If the vendor was not responsive to correcting deficient performance, a hearing was to be held by the Vendor Performance Committee.

The Committee had the authority to determine if a substantial breach of performance occurred. If the Committee decided there was a substantial breach of performance they could:

Terminate the contract.

Inactivate the vendor from the vendor commodity listing, and

Place documentation of poor performance in the vendor performance file.



We reviewed the documentation for four vendor hearings and found that three contracts were terminated as a result of the Committees determination.

We asked about the impact of removing vendor names from the vendor commodity listing and were told that the vendors could still pick up subsequent bids at the public counter and bid on other proposals.

Copies of the "Breach of Contract Warning Letter" are sent to the City Attorney and to the Purchasing Agent for inclusion in the vendor file. According to GSD, the departments sent back 200 letters and 44 were actually brought to a hearing and judgements were made.

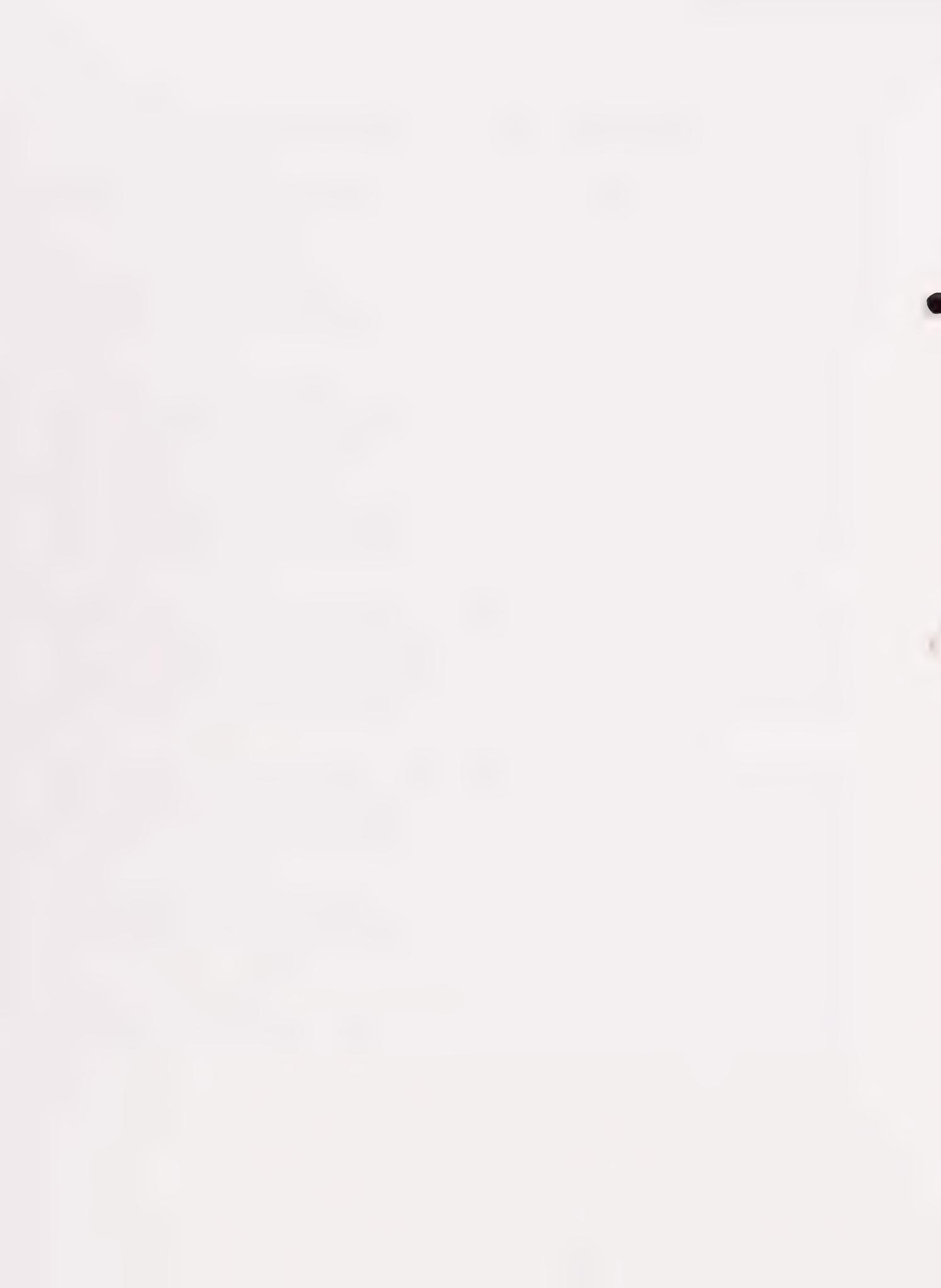
The Purchasing Division forwards the Renewal Notice for Annual Purchasing Agreement (GS/S1B) to each department authorized to purchase from contracts at approximately 120 days before a contract is due to expire. The departments are to indicate on the form if they require any changes from the existing agreement in specification, quantities or conditions, delivery points, estimated annual dollar expenditures, and whether vendor performance is good, fair, or unsatisfactory. The Director of Supplies speculated that departments did not conscientiously send back the GS/S1B to the Purchasing Division since it was not the departments' top priority.

The Market Research Section is in the process of developing procedures for evaluating vendor performance. As a pilot project started in October 1993, they started with the City Stores to complete the Vendor Performance Analysis Sheet for every delivery by a vendor. The contractor is evaluated on the timeliness of delivery, quality of goods, accuracy of quantity and billing, and vendor attitude. This will be input into MMS, after which a Vendor Performance Report will be generated.

Vendors with consistently unsatisfactory ratings will be recommended by the Market Research Section to the Performance Review Committee for counselling and further action. Feedback from the requisitioning department will be necessary. However, the Division does not have a clear implementation plan and timetable.

During the audit period and to the date of our report, vendor selection for bid invitation was based on these factors: the Buyer's familiarity with the vendor and its commodity; suggestions from the requisitioning department; recommendations from other buyers; and vendors ability to respond to previous bids.

There is no formal written policy to rotate buyers as an added control over purchasing. There is no mention of a buyer rotation policy in the Buyer Training Manual nor in the Procurement Manual.



According to the Director of Purchasing, Buyer Groups have been under constant reorganization. Prior to July of 1993, buyers were grouped into the Annual Group for the annual contracts and the One-Time Buying Group for one-time purchases. In July 1993, the buyers were formed into five commodity groups. Currently, there are four commodity groups, each headed by a senior buyer and staffed by two buyers. Because of the high turnover rate, buyers get assigned from one group to another.

Maintaining a vendor list based on pre-screening of historical performance is the starting point for an effective and efficient procurement process. The City needs information on vendors they can deal with and which vendors they should avoid.

Routine monitoring of vendor performance was not a priority of management. Prior to the creation of the Market Research Section in July 1993, there was no routine performance evaluation function performed by the Division. The Purchasing Division reviewed vendor performance only when user departments called to their attention serious problems with a vendor. Only in these cases, did the buyer investigate, call the vendor, or recommend a hearing with the Performance Review Committee. Waiting for complaints did not provide a process for continuing improvements.

Because of the lack of clear standard guidelines and routine vendor performance monitoring, there was no basis for the removal of a vendor from the vendor list other than lack of activity for a period of time.

Non-performing vendors could remain on the vendor list and continue to do business with the City in an inefficient manner. The quality of the goods delivered, accuracy of the vendors billing, and the vendors' attitude will remain unchecked and contribute to inefficiency.

There were no comprehensive written policies or standard guidelines to deal with non-performing vendors including options such as: forfeiture of performance bonds, penalty clauses incorporated in the contract in case of failure to deliver, deletion from the vendor list to prevent inclusion in future bids.

To enforce forfeiting the bonds, the Purchasing Division should have clear guidelines in requiring performance bonds in the first place. It was at the discretion of the buyers to waive this requirement. Furthermore, the reason for waiving the performance bond was not documented.

Any process that has no feedback has no systematic control mechanism to tell if goals are being accomplished as they were intended. Failure to monitor and periodically evaluate suppliers could mean that the organization may be dealing with suppliers of poor quality goods and services, or products that are less advanced technically or cost more.



B. The Purchasing Division did not have a routine contract and price analysis function to remain current on price and market trends to ensure that the City got the best available price.

There was no effective price trend and contract analysis function until July 1993 when the Market Research Section was formed. Beginning in July, contract analysis was done for contracts of \$50,000 and above.

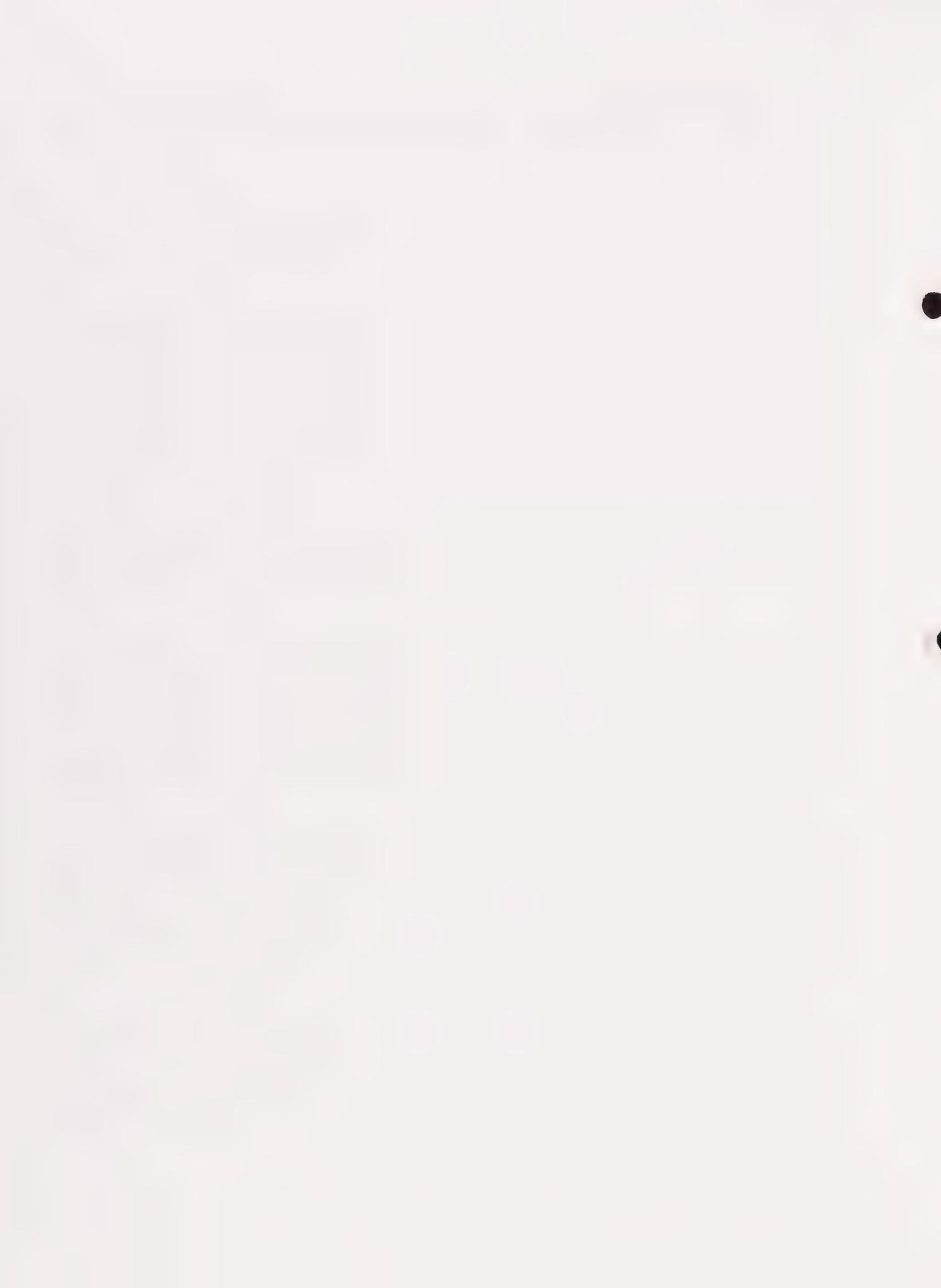
In January 1994, the Market Research Section came out with the "Procedures for Contract Analysis" to be used when a contract is up for its renewal option, when there is a request for a price increase, and when there is a request to add items. There are also procedures to review original bids for contracts, contracts with duplicates, and requests by contract supplier to assign contracts. The procedures vary but generally include: determining whether or not the contract price is tied to a Commodity Index; comparing the price to those obtained by other jurisdictions; and comparing the price with the current market price.

Effective in March 1994, the contract limit for analysis was increased to \$100,000. The Section is still in the process of upgrading "The Written Procedures for Contract Analysis" and making changes before they incorporate these into the Procurement Manual.

According to the Senior Buyer in the Market Research Section, Buyer attitudes have changed since July 1993, to being more careful and sourcing better to obtain the best available prices. The Buyers knew that the Market Research Section was overseeing them and analyzing their awards. The Section utilized BidTrax, which provided a customized Best Buys Report to help evaluate prices of a specified commodity and to compare purchases of a Buyer. Also, the Section used Dun & Bradstreet Supplier Evaluation Reports to determine vendors risk rating factors for certain large contracts.

When we inquired about the possibility of utilizing other government agency contracts like the County or State, we were told that the price comparison studies by the Market Research section have indicated that the City got a better price when contracting alone. For example, in the past the City shared the County's contract on pagers until the County required fees of 1% to 2%, resulting in higher prices than what the City could procure on its own. The County and State negotiate a significant number of their high priced bids, and this practice is not allowed by the City Charter.

The City is a member of the Los Angeles Metro Public Purchasing Agents Cooperative where members can bid as a group for certain commodities. Because various City requirements such as the Minority Business Enterprise and Affirmative Action are not required in these bids, the City does not participate. However, the Purchasing Division made comparisons between the City's prices and that of the cooperative before awarding or renewing annual contracts.



In the area of utilizing multiple vendor contracts, according to the Director of Purchasing, the practice was started in January 1994. Prior to that, Purchasing Division had multiple vendor contracts based on geographic regions. The City had also been jointly buying with DWP, Harbor, and Airports.

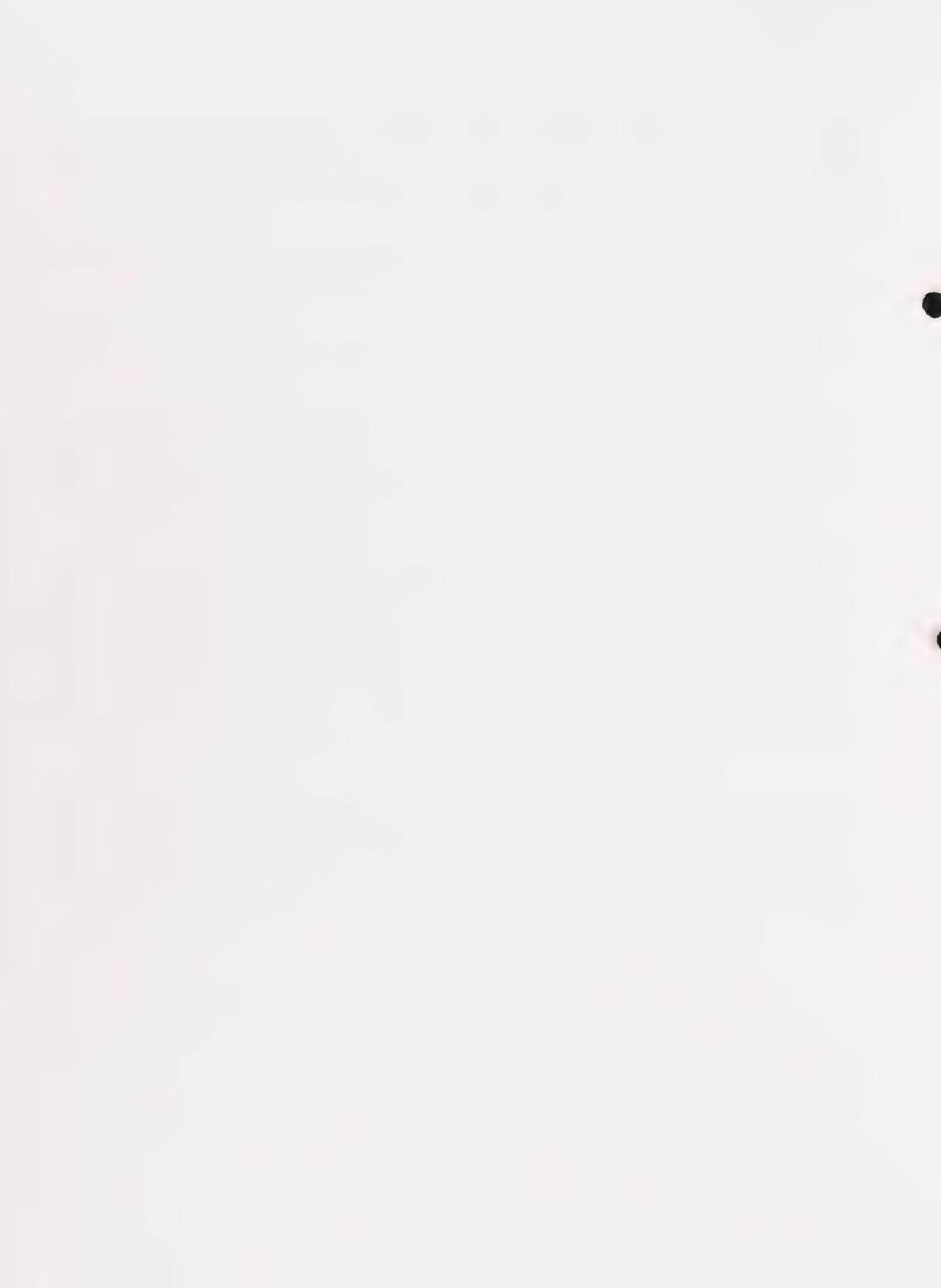
Contracts do not guarantee prices for the contract period because of changes in market trends. Standard contract language accommodates price increases. Vendors' requests for price increases are reviewed by the Section for appropriateness.

Price decreases were not accommodated in the current standard contract clauses except for contract prices tied to a manufacturer's published price list.

Because market prices fluctuate, price evaluation and analysis must be made on a current basis to assure that the City's contract prices remain the best available and standard contract language should include a clause for price decreases. Price evaluation and analysis should include the analysis of specification requirements and price differences among different brands for general equipment and supplies.

The Joint Report on Improving Purchasing Operations prepared by the City Administrative Office, dated February 6, 1989, realized the need for this function. According to the Assistant General Manager, about a year after the CAO report, GSD hired people for market research. The staff were on board for about a year but were reassigned because of budget cuts and reportedly nothing meaningful was accomplished. It was not until July 1993, when the Market Research Section was formed that some form of contract analysis was done. The Senior Buyer in the Market Research Section stated that his section lacks equipment and resources to successfully meet their goals.

Without a routine contract and price analysis function, there was no assurance that the City was paying the best available price for the quality of items purchased. Prices may decrease or increase and there may be vendors that are willing to give a lower price. Price analysis begins at the onset of the bidding process but must not end there. There is a need for a continuing evaluation process as prices change with changes in the market.

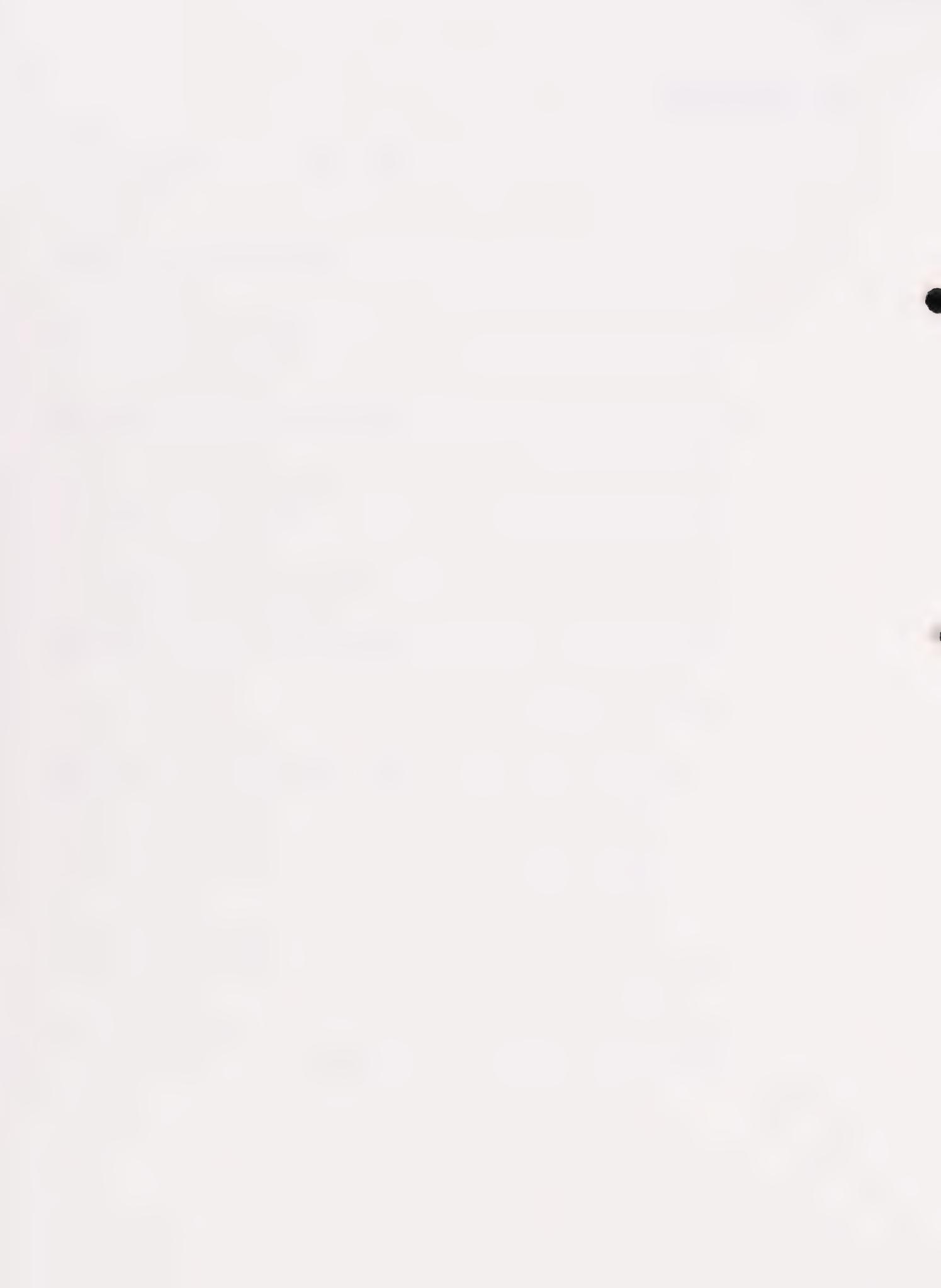


RECOMMENDATION

Strengthen Vendor Performance Analysis and Market Research Functions.

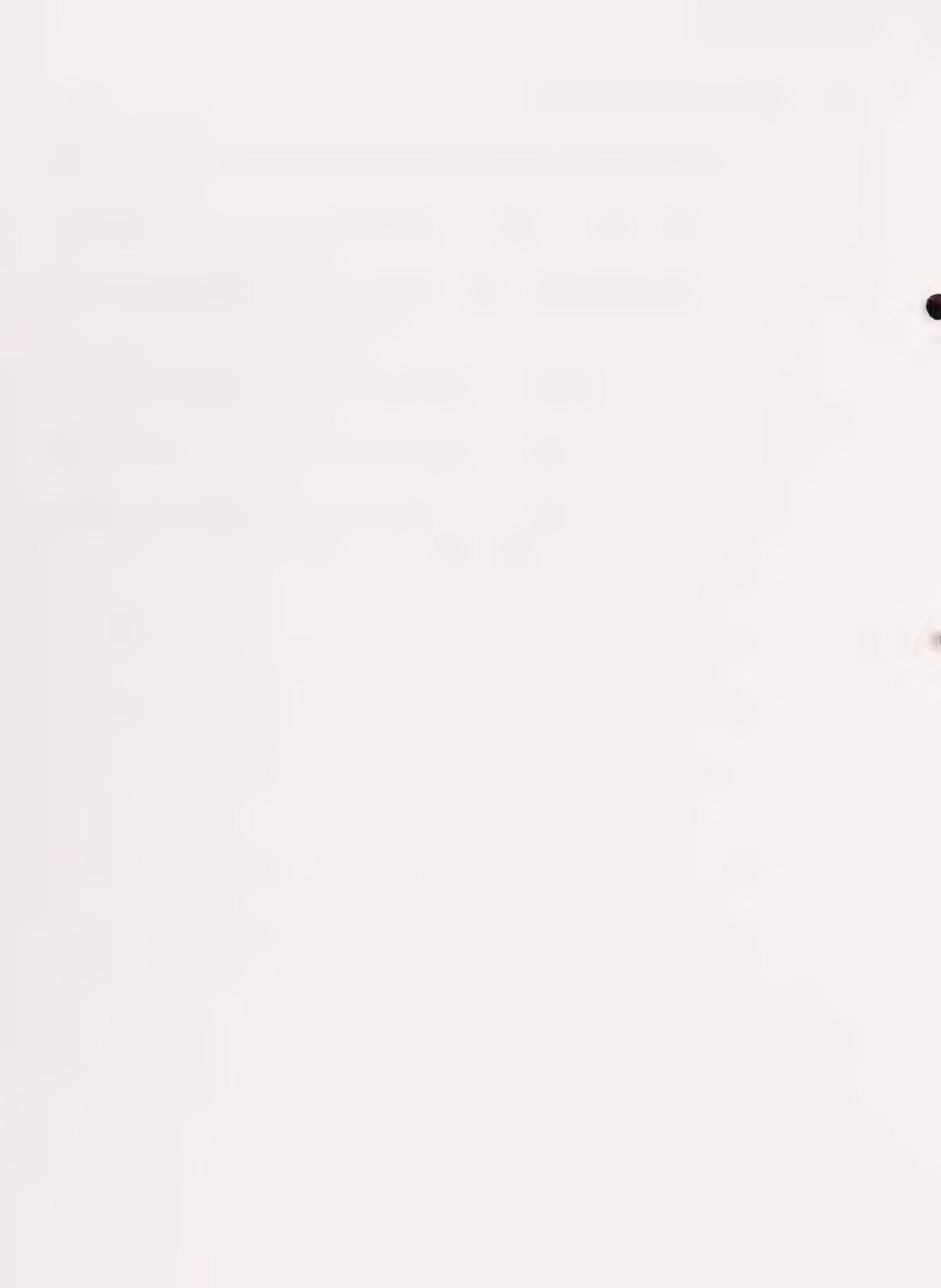
A. Vendor Performance

- Provide and implement clear Citywide policy and written guidelines for evaluating vendor performance.
- Develop a program to monitor the performance of vendors for key materials with high volume.
- Evaluate and enter vendor performance ratings in the Materials Management Systems so that the vendor file will accurately reflect true vendor performance.
- Update vendor list based on the current ratings, eliminating vendors with consistently poor ratings.
- Use vendor ratings when selecting vendors for invitation to bid.
- Clearly define a non-performing vendor. Establish Citywide policy and written guidelines on dealing with non-performing vendors. Enforce the policy against non-performing vendors.
- Demand performance such as:
 - ✓ Develop clear written policy and guidelines to require performance bonds and enforce forfeiting the bonds for failure to deliver,
 - ✓ Document the reasons for waiving the performance bond when they are waived,
 - ✓ Incorporate a penalty clause for non-performance in contracts,
 - ✓ Delete non-performing vendors from the vendor list and disqualify them from future bids.
- Institute a policy to rotate buyers, clearly stating the reasons why this is necessary and how this is to be implemented.



B. Contract and Price Analysis

- Conduct contract and price analysis on an ongoing basis to ensure the City gets the best available prices.
- Include a clause for price decreases in the standard contract language.
- Stay current on price trends in the market by establishing on-line access to commodity prices such as Data Resources that provides price forecasting and historical data of commodity prices.
- Analyze specification requirements and price differences among different brands and specifications when comparing commodity prices.
- Study and utilize contracts of government agencies such as the County, State, and the Department of Water and Power.
- Utilize multiple vendor contracts to ensure that the City is not stuck with buying from just one vendor, who may not have the product when it is needed or ask for a higher price.



FINDING NO. 2

Eighteen percent of the Purchase Orders issued were Emergency Purchase Orders resulting in reportedly higher costs for items purchased. The estimated overpricing was approximately \$489,000 for FY 92 and FY 93.

A. Some Emergency PO's were issued to acquire non-emergency goods which were routinely and regularly requisitioned. Emergency ordered goods were often delivered at higher prices on a regular schedule without the benefit of being an emergency.

The Purchasing Division issued 1,264 Emergency PO's for \$3,322,022 in FY 91-92 and 1,180 Emergency PO's for \$3,576,642 in FY 92-93 per reports provided by the Purchasing Division. This is 18% (2,444 of 13,456) of the total number of Purchase Orders/One-Time contracts issued during the period.

A test of 31 judgmentally selected Emergency PO's issued during FY 92-93 with a total value of \$576,508 revealed that:

- a) The goods on 13 (42%) PO's for \$220,400 were delivered after the required ten day period, ranging from 11 to 237 calendar days after the PO date. The average was 48 days.
- b) The goods on ten (32%) PO's for \$191,287 were delivered prior to the PO issuance, ranging from 14 to 167 days before PO date. The average was 67 days. These "Confirming Purchase Orders" were to confirm that goods were received as a result of an emergency before PO's were issued.
- c) The goods on seven (23%) PO's for \$144,343 were delivered within ten days of when the Emergency PO's were issued, with an average of four days.
- d) One (3%) PO for \$20,478 was canceled. (see (d) on page 25)

There were 15 (48%) of the 31 Emergency PO's that did not comply with the "Mandatory Requirements for Emergency Purchase Orders" policy. Two PO's for \$26,321 were not accompanied by the emergency justification forms. The other 13 PO's for \$241,571 came with the emergency justification forms signed by the section head only. The department head's signature for approval was missing.

Five of the 31 Emergency PO's had three telephone price quotes; 14 of them had one quote, and 11 of them did not have any quotes. One Emergency PO was to reimburse the Federal government and did not require a quote.

According to the GSD Procurement Manual and the Buyers Training Manual, requestors should contact at least three vendors for price quotes for items required within 24 hours before submitting the requisition for an emergency PO.

When the emergency occurs after working hours, the user department may request the items direct from a vendor and contact the Purchasing Division to obtain a "Confirming Order" no later than the next working day. A completed "Mandatory Requirements for Emergency Purchase Order" form, along with other required documents, must be forwarded to the Purchasing Division within ten calendar days.

The Procurement Manual defines emergency with five conditions. It states that an emergency exists under the following conditions:

- ✓ where there exists a threat to public health, welfare, or safety;
- ✓ where immediate repair is necessary to prevent further damage to public property, machinery, or equipment;
- ✓ where the item is needed at once to provide or restore adequate security;
- ✓ where the lack of the requested item would idle City work crews;
- ✓ where the lack of the requested item would create a situation that causes the City a substantial monetary loss.

We further looked into the justifications for nine of the 31 selected Emergency PO's. The results were:

- a) Two PO's for \$49,773 were emergency in nature.
- b) Four PO's with a total value of \$68,132 were issued for items of foreseeable need:
 - ✓ Speed switches for the truck loading facility at the Hyperion Plant.
 - ✓ Spare parts for the "truck loading modification project" at the Hyperion Plant.
 - ✓ Additional purchase of hydraulic pumps for the Fleet Services refuse trucks.
 - ✓ Excess of estimated amount for the purchase of special concrete at the Department of Recreation and Parks originally authorized through a One Time PO. They had to issue a "Confirming Order" of \$14,946 to pay for the additional amount of special concrete.

The user departments initiated the requisitions late and consequently requested an emergency purchase.

- c) Two Emergency Confirming Orders for \$34,625 were issued because the existing contract had expired or there was no contract. The emergency practice was necessary because the Purchasing Division failed to award a new contract on time.
 - ✓ The Bureau of Sanitation, not knowing that a contract had expired, issued a Sub PO for an item. The Sub PO was consequently not approved but the vendor fulfilled the delivery. The Bureau had to request a "Confirming Order" to take care of the payment of \$20,071.
 - ✓ The Purchasing Division did not have a contract for telephone equipment requested by one of the Council field offices. GSD had to obtain the equipment and complete a "Confirming Order" of \$14,555. The Purchasing Division was unable to explain why there was no existing contract.
- d) One Emergency PO of \$20,478 was issued on January 19, 1993 for refuse truck tires. The requestor indicated there was a need for an emergency purchase because there was no current contract.

The Material Management System Usage Inquiry showed that the GSD warehouse (C20) had these tires in inventory at that time. When our auditor contacted GSD to confirm the date goods were received, the Accounting Section stated that the tires were never delivered under this Emergency PO because the user was able to obtain the tires from the contract vendor and a request to cancel the Emergency PO was submitted on May 4, 1993. The PO was canceled on April 11, 1994 as a result of our follow-up.

Except for the two emergencies, the issuance of seven of these nine Emergency PO's could have been avoided with proper planning.

According to the Buyer Training Manual, emergency purchases are not intended for expediting purchases because of poor planning, overlooked requirements, inaccurate usage history, and/or inadequate forecasting.

However, as long as purchasing operations are perceived as slow and inefficient, user departments will continue with whatever means available to ensure an orderly supply process and satisfaction of their materials and equipment requirements.

B. Emergency orders were not properly controlled and split Emergency PO's were often issued to circumvent City requirements.

From July 1, 1991 to June 30, 1993, there were 19 occasions that 11 vendors were issued two or more Emergency PO's on the same day (split order). Each of these Emergency PO's was under \$25,000. The total amount of split PO's was \$707,769.

The examination of split Emergency PO's for seven (64%) judgmentally selected vendors revealed that:

- a) One vendor was issued two Emergency PO's on the same day because two different fund numbers were used.
- b) One vendor was issued three Emergency PO's on the same day: one for GSD-Fleet Services, two for the Los Angeles Police Department with no explanation of why two separate PO's had to be issued.
- c) Three vendors were issued more than one Emergency PO on the same day with no apparent reason.
- d) Two vendors were issued 22 Emergency PO's with a total value of \$378,619 for sulfur dioxide on nine occasions. The chemical was for the Tillman Water Reclamation Plant operation.

All the above split emergency orders were under \$25,000. Had any of these split orders been combined as one single Emergency PO, it would have exceeded the \$25,000 limit and the procurement would have required the formal competitive bidding process, or it would have required the Council's approval to be exempted from advertising.

GSD categorized five emergency conditions. The category was so general that virtually all items requested by City departments can fit into at least one of the conditions and become justified for emergency buy. However, when the need for items is foreseeable, the users should have planned their requisitions in advance.

The County of Los Angeles defines an emergency as a sudden, generally unexpected occurrence or set of circumstances demanding immediate action. If immediate action is not taken, essential services cannot be continued or there could be an economic loss to the County. The key words "a sudden, generally unexpected occurrence" should be included in the City's definition to avoid issuing Emergency PO's for items of foreseeable need.

The Purchasing Division did not assume the responsibility to monitor the Emergency PO's. Items under Emergency PO's not delivered within ten days from the PO date as required per Procurement Manual were still accepted. Furthermore, the Purchasing Division did not review the purchase requisition documents to ensure those were

complete. Also, split Emergency PO's issued to the same vendor on the same day were allowed simply because separate emergency purchase requisitions were submitted by the user department.

In some instances, the Purchasing Division would not know the departments had ordered and accepted some materials until they requested "Confirming Orders" to pay the vendors.

The ambiguous definition of emergency and tolerance of late deliveries confused the requestors in determining what was an emergency. Allowing the issuance of Emergency PO's without justifications and department head's approval encourages the requestors to use them as a means of convenience. These unwarranted Emergency PO's disrupt the routine procurement channel. Also, an emergency PO allows the requestor to search for a vendor and place the order directly. Abusing the emergency PO procedures might involve possible favoritism toward particular vendors.

Emergency PO's not timely canceled creates inaccurate information about Purchasing. It also increases the work load of the buyers and system personnel.

As stated in the Buyer's Training Manual, the increasing number of Emergency PO's results in higher costs to the City for the following reasons:

- the lowest possible price cannot be obtained with the insufficient time available for the suppliers to carefully prepare a bid;
- higher transportation costs needed to expedite shipments;
- special handling charges by vendor; and
- special attention required of Purchasing personnel.

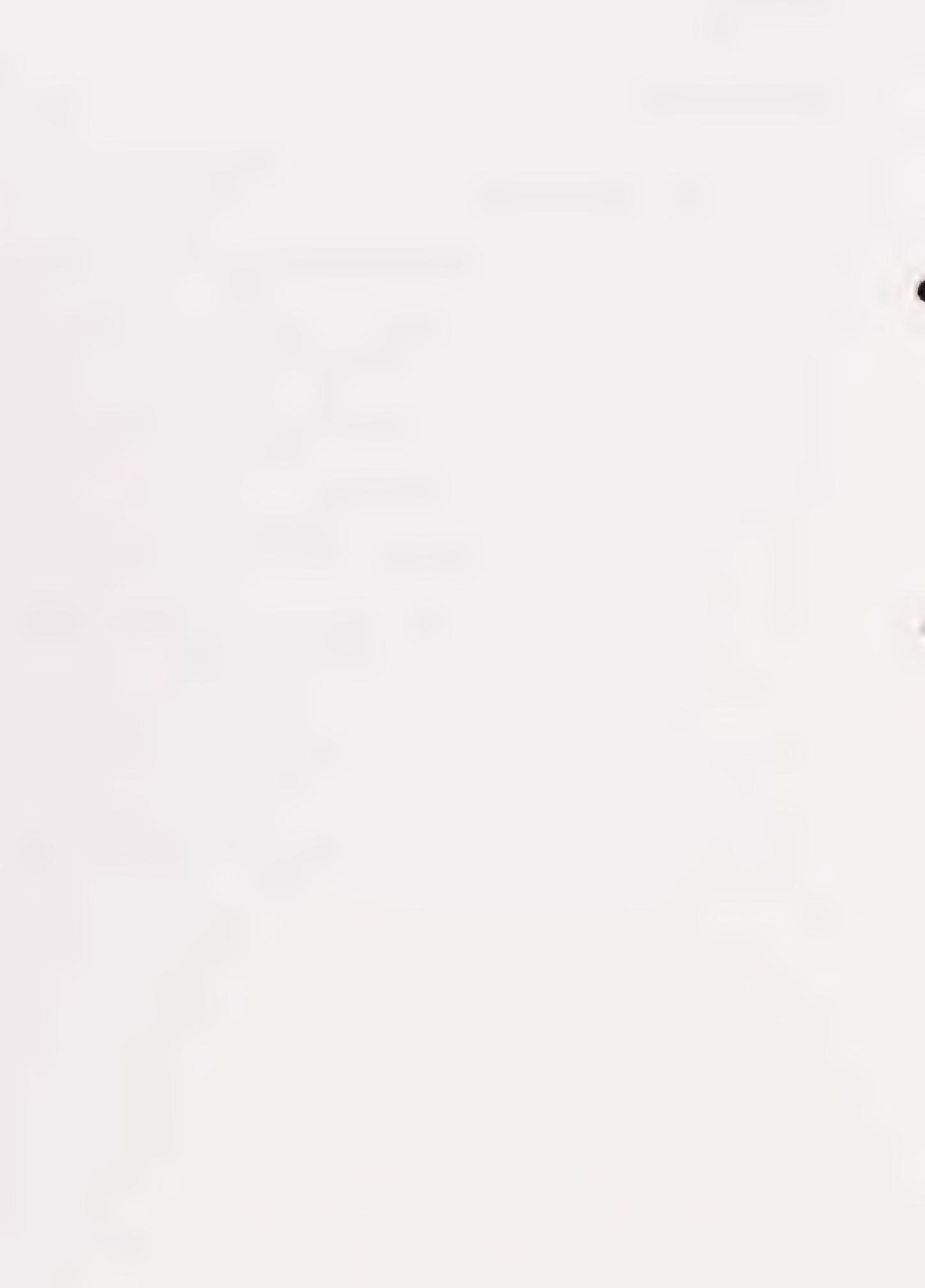
The Emergency Purchase Orders committed the City to purchase goods without the benefit of competitive bids. This practice may have precluded the City from obtaining the lowest possible price. According to one of the senior buyers, the vendors' profit margin at competitive bidding is about two to three percent (average 2.5%). The buyer estimated vendors expect 10 to 15% (average 12.5%) if there is no competitive bidding. He estimated that the City is paying the higher profit margin for the Emergency PO's. That means an additional cost of 10% (12.5 - 2.5).

The Purchasing Division issued Emergency PO's of \$3,322,022 in FY 91-92 and \$3,576,642 in FY 92-93 for a total of \$6,898,664. The competitive price is estimated to be approximately \$6.2 million. Based on buyer's input on profit margin, the additional cost for issuing Emergency PO's was estimated at \$627,000 even though some emergency purchases were unavoidable, as represented by two (22%) out of nine in the sample we tested. The balance of 78 percent representing those emergency orders that were avoidable, may have cost the City as much as an additional \$489,000.



RECOMMENDATION

- Assume the responsibility to monitor the emergency PO's as part of enhancing the overall procurement process.
- Plan and coordinate with the user departments in order to maintain an ongoing contract or purchase through a PO with competitive prices.
- Clearly define the nature of emergency; Communicate with the user departments to ensure that they have a clear understanding of what an emergency is and the requirements for an emergency PO.
- Implement the review of required Emergency PO documents and enforce the guidelines set in the Procurement Manual and/or Buyer's Training Manual.
 - ✓ Enforce the 10-day delivery requirement.
 - ✓ Enforce the Mandatory Requirement for Emergency Purchase Order form approved by the department head.
 - ✓ Have the employee(s) who failed to prepare the confirming order 10 days after receiving the Emergency Purchase Order number personally liable for the purchase as specified in the Procurement Manual.
 - ✓ Process cancellation of Emergency PO's once the request is submitted.
- Require three competitive bids as specified in the Buyers Training Manual, or revise the policy if the bids are not practical for Emergency PO's.
- Disallow the issuance of Emergency PO's to the same vendor on the same day, which is often intended to circumvent the City's bid requirement for advertisement and formal competitive bidding process.



FINDING NO. 3

Purchasing Division did not have a demand analysis function for materials and supplies.

The Purchasing Division did not have realistic quantity and volume estimates for materials and supplies to be used by the City. The annual contract amount for key materials and supplies was not based on reasonable demand estimates. As a result, annual contract amounts were increased at numerous times without receiving volume discounts and lower competitive prices based on the larger contract amount.

The GS/S1B is a computer generated survey form forwarded by the Purchasing Division to departments to see if they still need contracts, if any modifications are needed, or if there are any changes in their estimated expenditures for the new contract period.

According to the Procurement Manual, this form shall be returned to the Purchasing Division or the department may not be authorized to use the contract if the contract is renewed. However, departments, which are not authorized on the contract due to late return of the Renewal Notice or for other reasons, are allowed to add on by requesting a contract modification.

The Director of Supplies stated that the GS/S1B was not the most effective or accurate way of determining estimated needs. Departments would not always respond or would merely indicate the prior year's estimate instead of taking time to make a realistic estimate.

Currently, the Purchasing Division relies more on historical data provided by the Financial Management Information System (FMIS) to determine what was purchased on a particular contract.

The Purchasing Division also uses MMS for their estimates. However, not all departments use the MMS, so information may not be accurate.

Per the auditor's request, the Purchasing Division provided "Annual Authority Amendments Report" of change orders issued after January 1, 1993. The DB2 report listed 2,254 change orders for 998 contracts for the period from January 1, 1993 to November 24, 1993. The report indicated the vendor, contract number, amendment number and date, but did not indicate any change order amount.

The Senior Management Analyst of the Administrative Services Section could give no assurance as to the accuracy or completeness of the report. Prior to January 1, 1993, no Change Orders (CO's) were recorded in the MMS.



We reviewed five of the contracts that had numerous change orders. The approximate number of CO's issued for our sample was based on the copies maintained at the Demand Audit section of the Controller's Office and the files at the Purchasing Division including those recorded in MMS. All five contracts exceeded the original estimates by between 143% and 4,833%. Total increases per contract ranged from \$42,599 to \$1,450,000.

CONTRACT PERIOD	CONTRACT NO.	ORIGINAL ESTIMATE*	CONTRACT AS OF 12/93	TOTAL # C.ORDERS	NET INCREASE	%
1. SAFETY SUPPLY AMERICA CORP - Safety Equipment & Supplies						
06/01/90 07/31/94	52093	\$ 30,000	\$ 1,480,000	46	\$ 1,450,000	4,833 %
2. FACILITY SPACE SOLUTIONS - Office Chairs						
07/01/92 06/30/95	53724	\$ 195,000	\$ 474,000	36	\$ 279,000	143%
3. CONTINENTAL TIME CLOCK CO - Time Stamp Equipment Parts						
02/01/91 01/31/94	52520	\$ 7,000	\$ 49,599	30	\$ 42,599	609%
4. SIMPLER LIFE EMERGENCY PROVISIONS - Emergency Supplies & Kits						
10/12/92 10/31/94	53906	\$ 20,000	\$ 127,500	14	\$ 107,500	537%
5. ANGELUS BUSINESS SYSTEMS - Repair Parts for Canon Typewriters and Calculators						
04/01/93 03/31/94	54201	\$ 10,000	\$ 103,700	38	\$ 93,700	937%

* Annual estimate of expenditures at bid opening.

For four contracts (#1,#2,#4,#5) and accompanying change orders, there was no reasonable quantity and volume estimates prepared by the Purchasing Division for the future needs of all City departments. Original contract amounts had to be amended by change orders as user departments requested and were allowed to add on by the Purchasing Division.

Contract #3 (Continental Time Clock Co) was executed on February 1, 1991 with an initial contract of \$7,000. In July 1992, GSD abolished the Office Equipment Repair Section and requested departments to use the contract for the repair of equipment. As of December 1993, the contract was amended with change orders increasing the contract amount to \$49,599.

The City may have obtained better prices had they originally requested bids for an annual contract with a larger volume. The contract language also did not provide for quantity or volume discount clauses to allow the City to obtain lower prices for added volume or quantity. As the contract amount increased with change orders, the prices remained the same.

On July 13, 1992, Executive Directive 16 was issued to address this problem based on concerns by the Controller. The Directive provided that:

- The Purchasing Agent is responsible for preparing quantity and volume estimates, with the assistance of departments where appropriate, based on historical expenditure records provided by the Controller's Office.
- The Purchasing Agent will develop and institute quantity and volume estimates and require bidders to quote a price that would favor the City when departments' usage exceeds estimated requirements.
- The Controller's Office will monitor and identify contract expenditures that have the potential for exceeding the original estimated amount by 100 percent or \$100,000 and inform the Purchasing Agent and involved departments.
- Where appropriate, the City at its option, will re-bid contracts.

For comparison, the Department of Water & Power's established limits for formal contracts states: "Cumulative changes may not exceed the lesser of 20% of the original contract price or \$100,000, unless specifically authorized by the Board.

The County of Los Angeles does not have an established limit for change orders. However, contracts with a cumulative amount exceeding \$25,000 require approval by the Board of Supervisors.

According to the Director of Supplies, the Purchasing Division did not implement any new procedures to comply with Executive Directive 16. There were no planning procedures to estimate the realistic demand for key materials and supplies. Contracts that substantially increased by more than 100% over the original amount were not monitored to determine the need for a re-bid. There were no volume and discount clauses for lower prices when the city bought more than the original contract amount. Improvement in the demand analysis function will enable the City to negotiate a better price.

RECOMMENDATION

- Develop a periodic report which provides management with a listing of change orders with dollar amounts.
- Hold planning sessions with departments and develop City-wide procedures to systematically estimate the demand for key materials and supplies.
- Reflect quantity and volume estimates in original contract bid and award process.
- Develop and institute quantity and volume discount clauses in contracts.
- Coordinate with the Controllers Office to monitor and identify contract expenditures exceeding the original estimated amount by 100 percent or \$100,000 in compliance with Executive Directive 16.

FINDING NO. 4

The City's bid and procurement requirements were not updated and cost the City money by requiring excessive paperwork. The requirements also delayed the procurement process and may have eliminated competitive vendors.

A. A majority of Purchase Orders are issued for minor purchases.

The analysis of Purchase Orders issued for FY 92-93 showed that 1,301 (22%) out of 6,193 Purchase Orders were purchases less than \$500 and 2,624 (43%) were purchases less than \$1,000. The dollar volume of minor purchases totalled \$413,861 (1%) for \$500 or less and \$1,364,257 (2%) for \$1,000 or less out of the \$60,118,800 total.

Further analysis showed that the volume of purchase orders was concentrated in purchases less than \$5,000. This represented 80% (4,955) out of a total of 6,193 Purchase Orders. In terms of dollar amounts, this was 11% of the total.

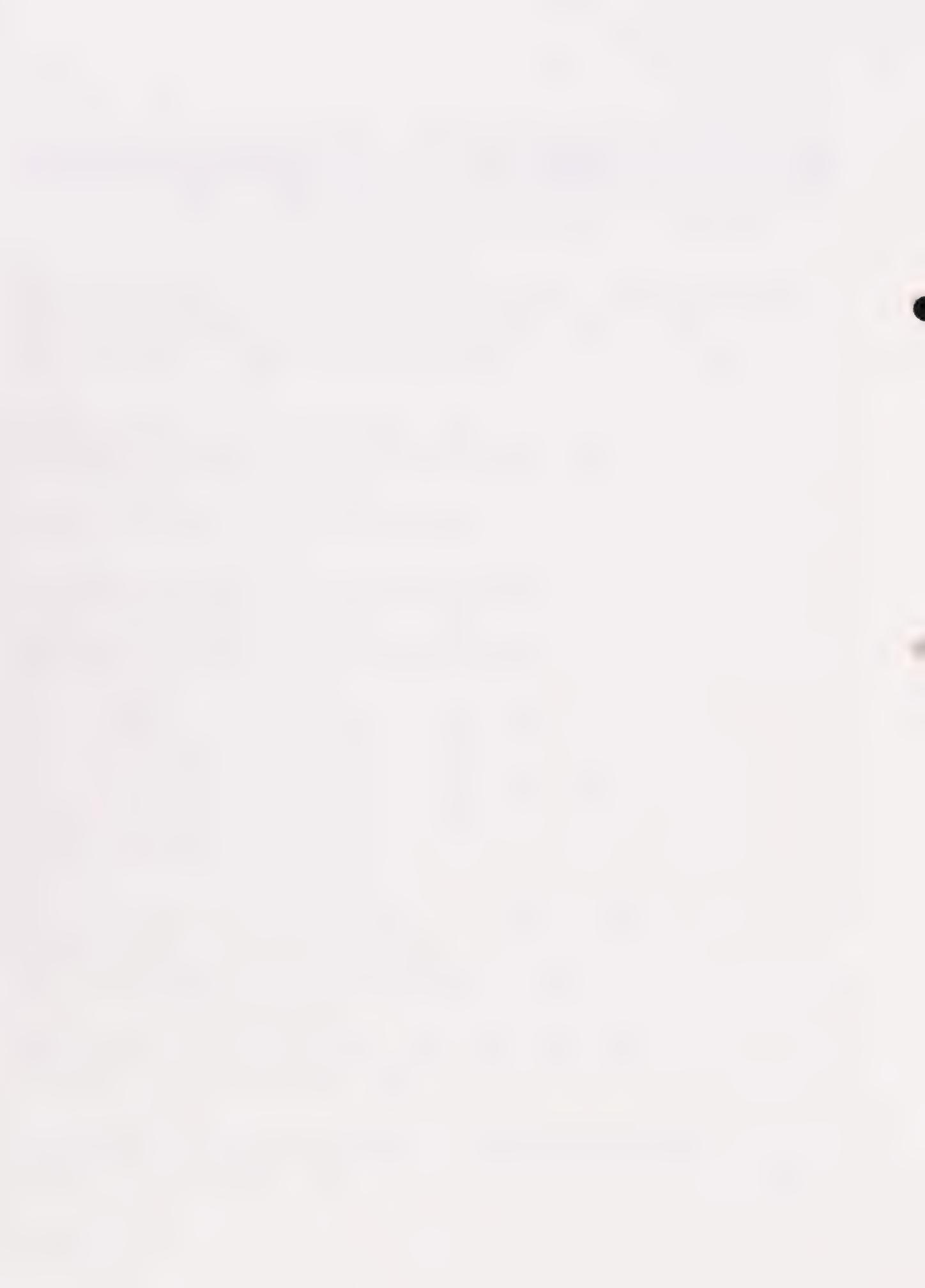
According to the data obtained from the FMIS, the PO's issued are summarized as follows:

CATEGORY < or =	COUNT	%	CUM. %	AMOUNT	CUMULATIVE AMOUNT	CUM. %
\$ 100	40	1	1	\$ 2,723	\$ 2,723	
200	161	3	4	25,116	27,839	
500	1,100	18	22	386,022	413,861	1
1,000	1,323	21	43	950,397	1,364,258	2
2,000	1,146	18	61	1,641,973	3,006,231	5
5,000	1,185	19	80	3,782,014	6,788,245	11
20,000	882	14	94	9,010,295	15,798,540	26
100,000	295	5	99	11,255,642	27,054,182	45
>100,000	61	1	100	<u>33,064,618</u>	<u>\$60,118,800</u>	100
TOTAL	6,193	100		\$60,118,800		

According to the Director of Supplies, the Purchasing Division incurred an average of approximately \$70 of direct salary cost (Sr. Buyer & Buyer) to process a PO. The average assumes all PO's take approximately equal resources to process.

Using the average cost of processing a PO, for PO's of \$500 or less, Purchasing Division incurred \$91,070 (\$70 x 1,301) of direct salary costs to process PO's worth \$413,861.

Using the average cost of processing a PO, for PO's of \$1,000 or less, Purchasing Division incurred \$183,680 (\$70 x 2,624) of direct salary costs to process PO's worth \$1,364,258.



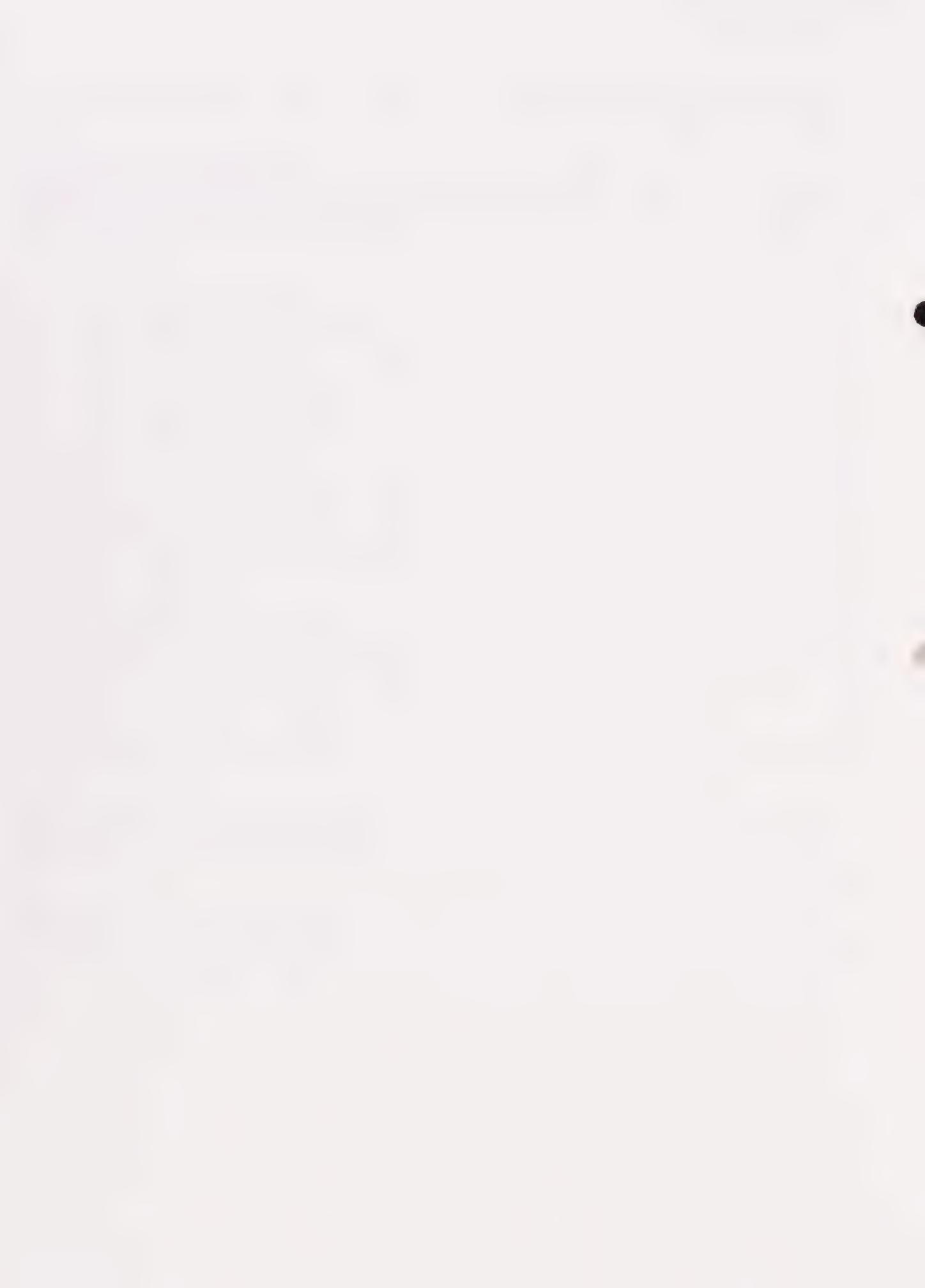
The Purchasing Division should propose a revised process for small PO's in terms of cost effectiveness.

For benchmarking purposes, we gathered data from Ernst & Young's report dated April 1994, on their review of Miscellaneous Minor Purchases at the Department of Water & Power. A comparative study of minor purchases limits among utility companies was as follows:

	Metropolitan Water District	So. Calif. Edison	So. Calif. Gas Co.	DWP
What is considered a minor purchase?	\$500 Equip cannot be purchased	\$2,500 Service can't be purchased	\$500 or food & entertainment	\$500
How are minor purchases funded?	Draft/petty cash \$100	Local PO credit card	Petty Cash PO	PO, Blnkt Auth, Trust Funds
Cumulative limit	\$500/vendor/day	LPO-budget Card-per month & SIC	\$5,000/purchase 10,000/yr	\$10,000

All the utility companies in the review considered \$500 as a minor purchase except So. Cal. Edison which used \$2,500. GSD uses the \$200 limit for the amount of blanket authority for minor emergency purchases.

The City Charter and the Administrative code limit the amount of Petty Cash purchases to \$100 and Blanket Sub-Purchase Orders to \$200 for emergency purposes only. The Purchasing Division has to generate a PO for non-emergency items not in contracts.



Spending considerable resources for PO's under \$500 that represent less than 1% (\$413,861 / \$60,118,800) or for PO's under \$1,000 that represent 2% (\$1,364,258/ \$60,118,800) is not efficient and contributes to the delay in processing Purchase Requisitions. The four Outstanding Requisitions Reports provided by GSD showed:

Outstanding Purchase Requisitions					
Date of Report	Under 30 Days	30 to 59 Days	60 to 89 Days	Over 90 Days	Total
6/1/93	127	257	52	68	504
7/1/93	26	10	27	52	115
1/1/94	419	107	53	37	616
2/1/94	377	255	42	54	728

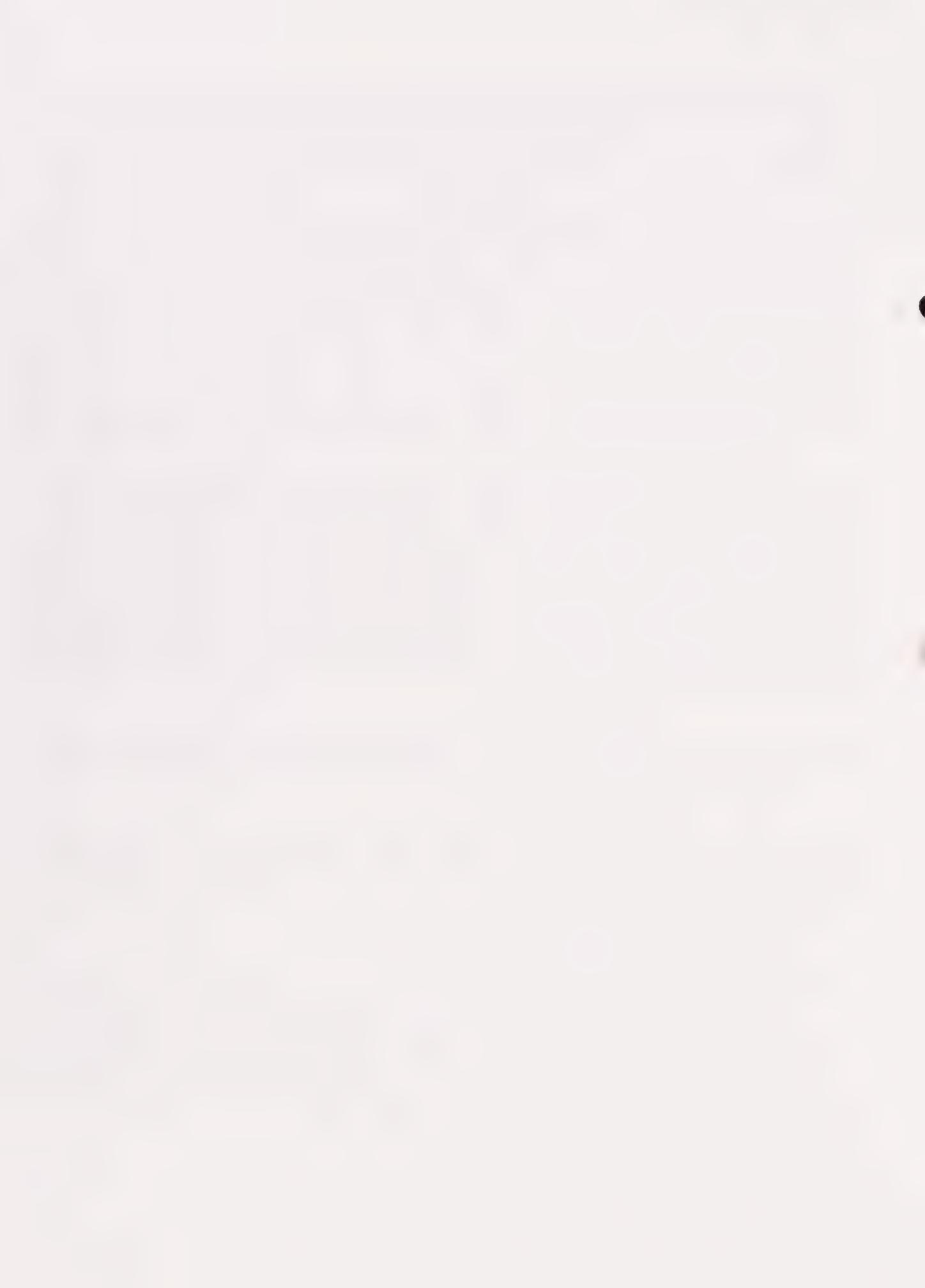
According to the Completed Requisitions Report as of July 1, 1993 provided by the Purchasing Division, the average number of days to process requisitions was 99 days. According to the Director of Purchasing, it takes an average of 56 days to process Purchase Requisitions to generate PO's and four to five months to generate an annual contract. While most of the outstanding requisitions were ready for processing, some might need additional information such as specifications from the user departments and other City required documents. With less PO's to process, resources can be used to reduce processing time of PO's and can be switched to market research and contract analysis functions.

B. The City's Procurement rules and regulations were not effective and result in over regulation.

Some City procurement rules and regulations were not amended for 10 or 20 years and were not seriously evaluated by the Purchasing Division to determine their applicability to current conditions.

COMPETITIVE BIDDING

Section 391 of the City Charter and Section 9.1 and 9.5 of the Administrative Code require that: "All purchases of materials, supplies, equipment and equipment rental, or of repair and maintenance services... shall be made by the Purchasing Agent of the City, from the lowest and best regular responsible bidder... A written offer and acceptance shall be obtained for all purchases in excess of five hundred dollars." (Amended, 1965.)



To this effect, the Procurement Manual states that all purchases including emergency purchases, are subject to competitive bidding. It further requires that the Purchasing Division shall process a written bid for all Purchase Orders in excess of \$500 including Emergency Purchase Orders.

Allowing negotiation of price for purchases under \$5,000 would free staff from procuring three bids for small PO's which account for 58% of the total PO's issued. Also, the Purchasing Division could negotiate better prices when it has flexibility in dealing with low bid vendors.

The City could still maintain competitive bidding policy on purchases over \$5,000, which amounted to \$53,330,555, 89% of total PO amounts issued.

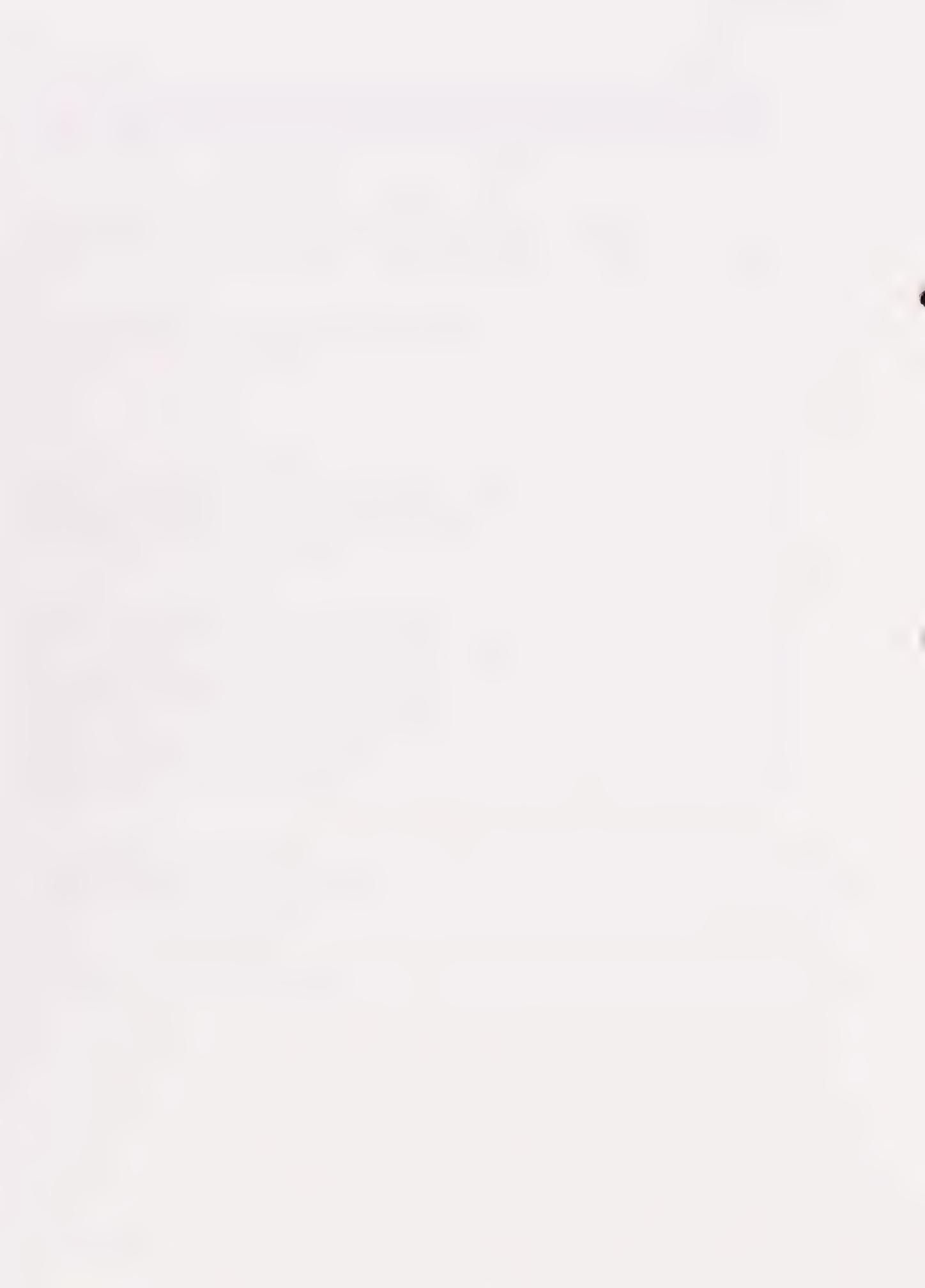
PUBLIC ADVERTISING

Section 10.15 of the Administrative Code, as amended effective June 30, 1984, requires public advertising at least once in a daily newspaper printed and published in the City for contracts involving the expenditure of more than \$25,000. However, it is the policy of the Purchasing Division to advertise bids from \$20,000 and above.

The Purchasing Division advertises in the Daily Journal and other selected publications if desired. Most advertised bids allow 21 days for bidding. For fiscal year 92-93, there were 295 (83%) PO's with amounts between \$20,000 and \$100,000 and totalling \$11,255,642 (25%) out of 356 PO's totalling to \$44,320,260 that would require public advertising per Section 10.15 of the Administrative Code and/or the policy of the Purchasing Division. The dollar amount limits in the regulations on Public Advertising were set in 1984 when the City's volume of Purchasing was less in terms of the number of requisitions it processed.

With outdated regulations, the bulk of the workload is concentrated on the minor purchases that were large in volume but were only a small percentage of the dollar amount. The clerical functions were tied up to monitor compliance to these regulations. These equated to time and money and advertising costs.

For benchmarking purposes, the following are the regulations required of vendors doing business with other agencies:



PUBLIC ADVERTISING

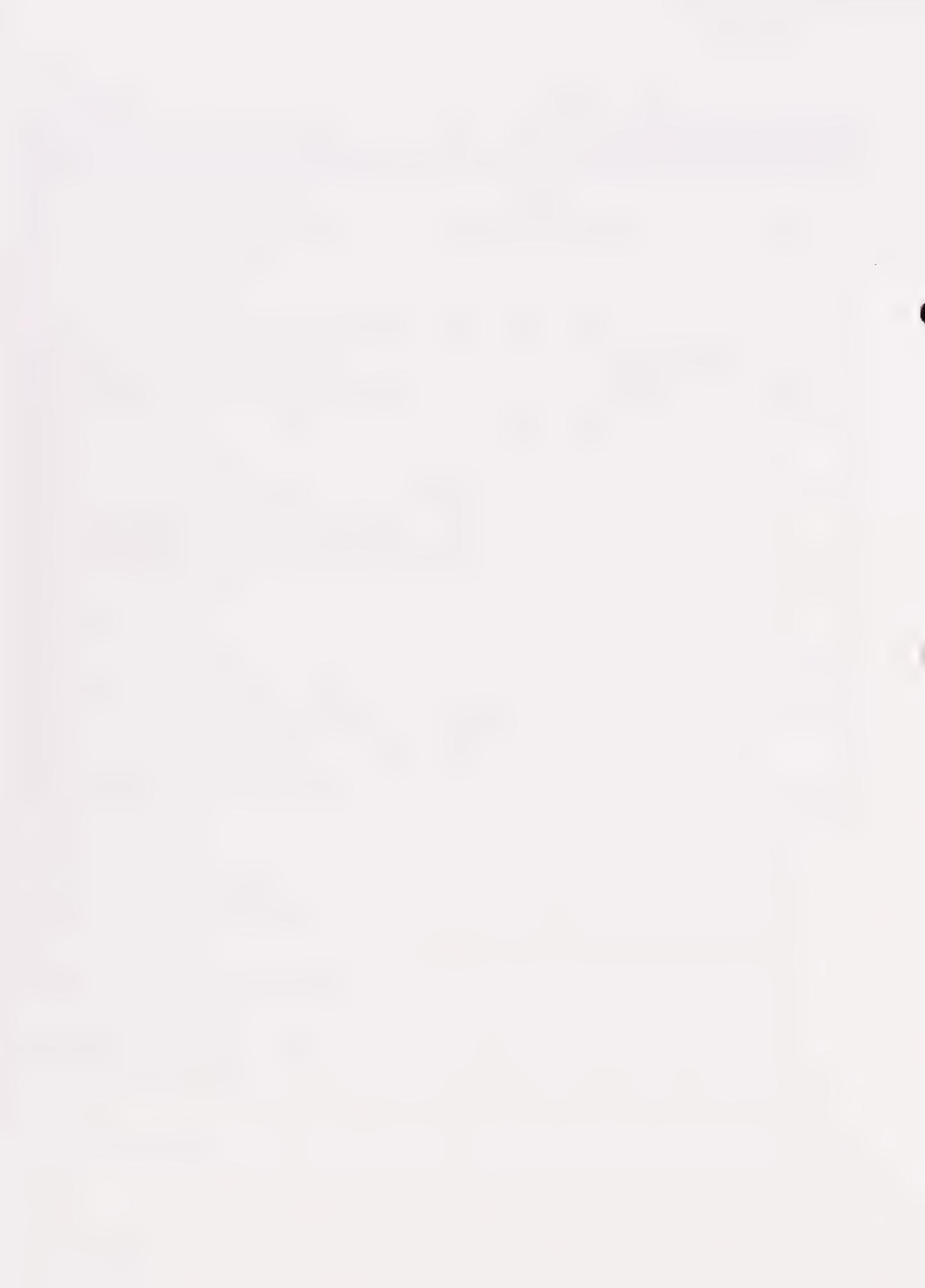
STATE	Uses pre-approved bidder list, advertisement optional.
COUNTY	No advertising requirement, but commonly done.
SC GAS CO	No advertising requirement.
CITY	> \$ 25,000 requires public advertising.

COMPETITIVE BIDDING

STATE	< \$ 10,000 informal bid, minimum 2 bids > \$ 10,000 formal bid
COUNTY	< \$ 1,500 - two solicitations; > \$ 1,500 but < \$ 5,000 - three solicitations minimum; > \$ 5,000 but < \$25,000 - reasonable sampling of bidders list; > \$ 25,000 - written solicitation to a reasonable sampling of bidders; > \$100,000 - formal bids;
SC GAS CO	> \$ 6,000 written bids
CITY	< \$ 500 three quotes required, need not be written; > \$ 500 = < \$25,000 informal written bids > \$ 25,000 formal written bids

RECOMMENDATION

- Eliminate the emergency provision for using Blanket PO's to allow their use in routine purchases.
- Increase the Blanket Sub-PO's to \$500 or \$1,000 in order to procure minor purchases with Blanket Sub-PO's instead of Purchase Orders.
- Analyze and evaluate the criteria for the City's bid and procurement requirements to determine the effectiveness and propose changes to the Council.
- Allow for negotiation of price for small purchases when such negotiation is in the best interest of the City.



FINDING NO. 5

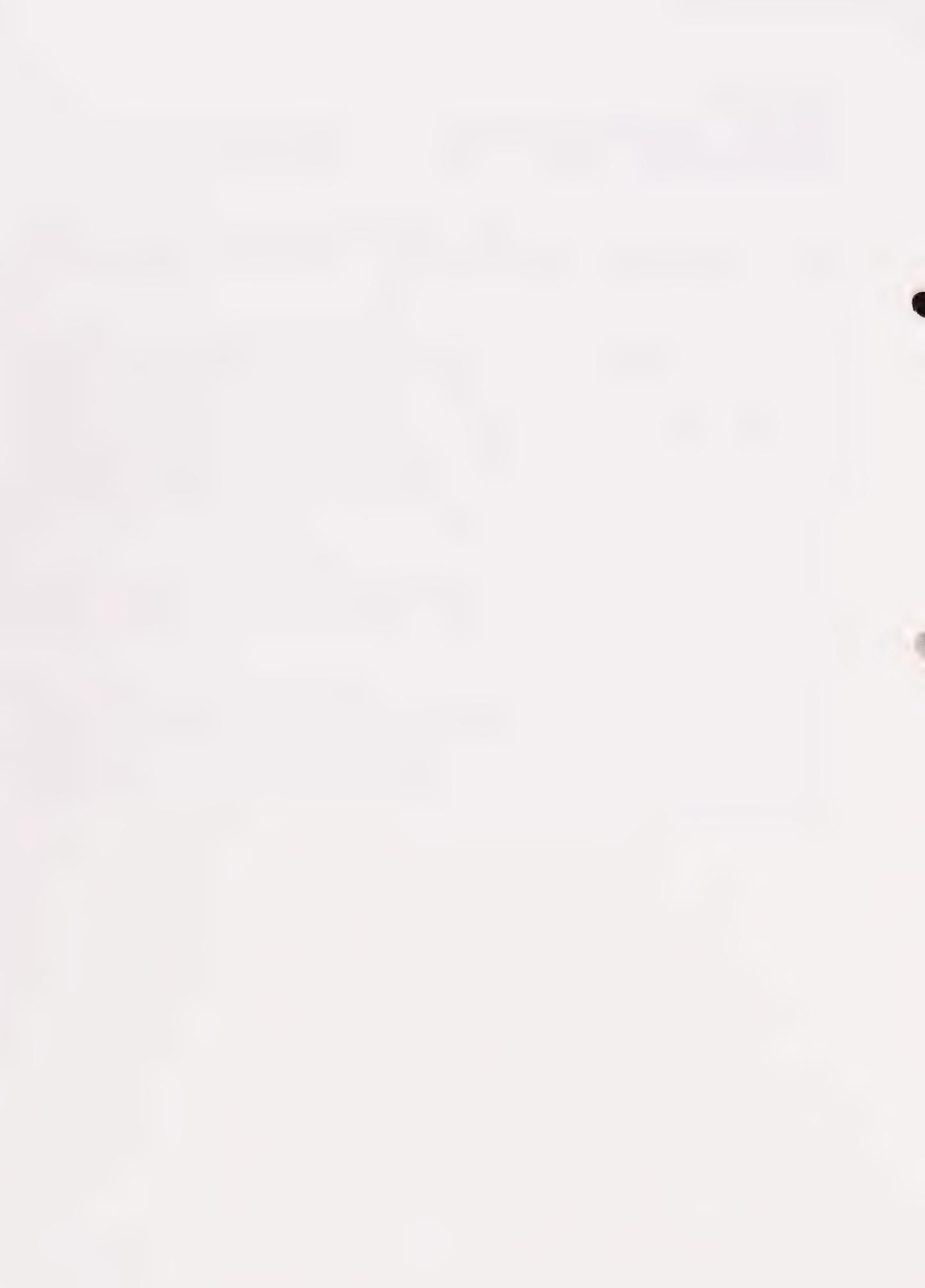
Seven Million Dollars of Purchase Orders were open for more than 60 days as of December 31, 1993.

The Purchasing Division did not monitor vendors for non-delivery of goods within the delivery period specified in the Purchase Order. All Purchase Orders specified a delivery period, which are mostly under 30 days.

GSD generates a weekly "Delivery Past Due Report" from the MMS for all PO's and Sub-PO's that were not delivered. The report shows Order Date and the expected Delivery Date by Order Number. This report is for information only and distributed to the departments bi-weekly to follow up on the delivery or to correct the data if they were already delivered. The report of October 9, 1993 provided to the auditors showed that of the estimated 10,000 PO's and sub-PO's listed, approximately fifty percent were for the funds GSD accounts for. Departments are not required to respond to the report. The credibility of the information is doubtful according to the Senior System Analyst in charge of MMS.

The Controller's Office generates a monthly report titled "Purchase Orders Overdue Notice Report for PO's Over 60 Days Old" and distributes the reports to the departments for their analysis and review. This report lists those PO's that were not paid and remain encumbered.

According to the Director of Purchasing, the Purchasing Division was not aware of this report and it was not the Buyer's responsibility to follow up on outstanding Purchase Orders. There were not enough resources in the Purchasing Division to handle 40 City departments. Furthermore, it would be easier for the requestor to keep track of the delivery and follow up. User departments did monitor only when they had extra time or the requisitioner asked them to follow up.



An analysis of the "Purchase Order Overdue Notice Report for PO's Over 60 Days Old" as of May 31, 1993 and December 31, 1993 were as follows:

AS OF MAY 31, 1993					AS OF DECEMBER 31, 1993				
FY ISSUED	COUNT	%	AMOUNT	%	COUNT	%	AMOUNT	%	
87	41	2	\$ 53,943	1	2	0	\$ 149	0	
88	6	0	52,482	1	2	0	1,457	0	
89	94	5	62,401	1	80	4	47,915	1	
90	206	11	288,901	4	108	5	202,060	3	
91	242	13	935,827	15	253	12	583,056	9	
92	431	23	1,882,327	30	**405	20	1,519,590	23	
93	878	46	3,042,100	48	*787	39	3,500,879	50	
94					405	20	1,077,382	14	
TOTAL	1,898	100	\$6,317,981	100	2,042	100	\$6,932,488	100	

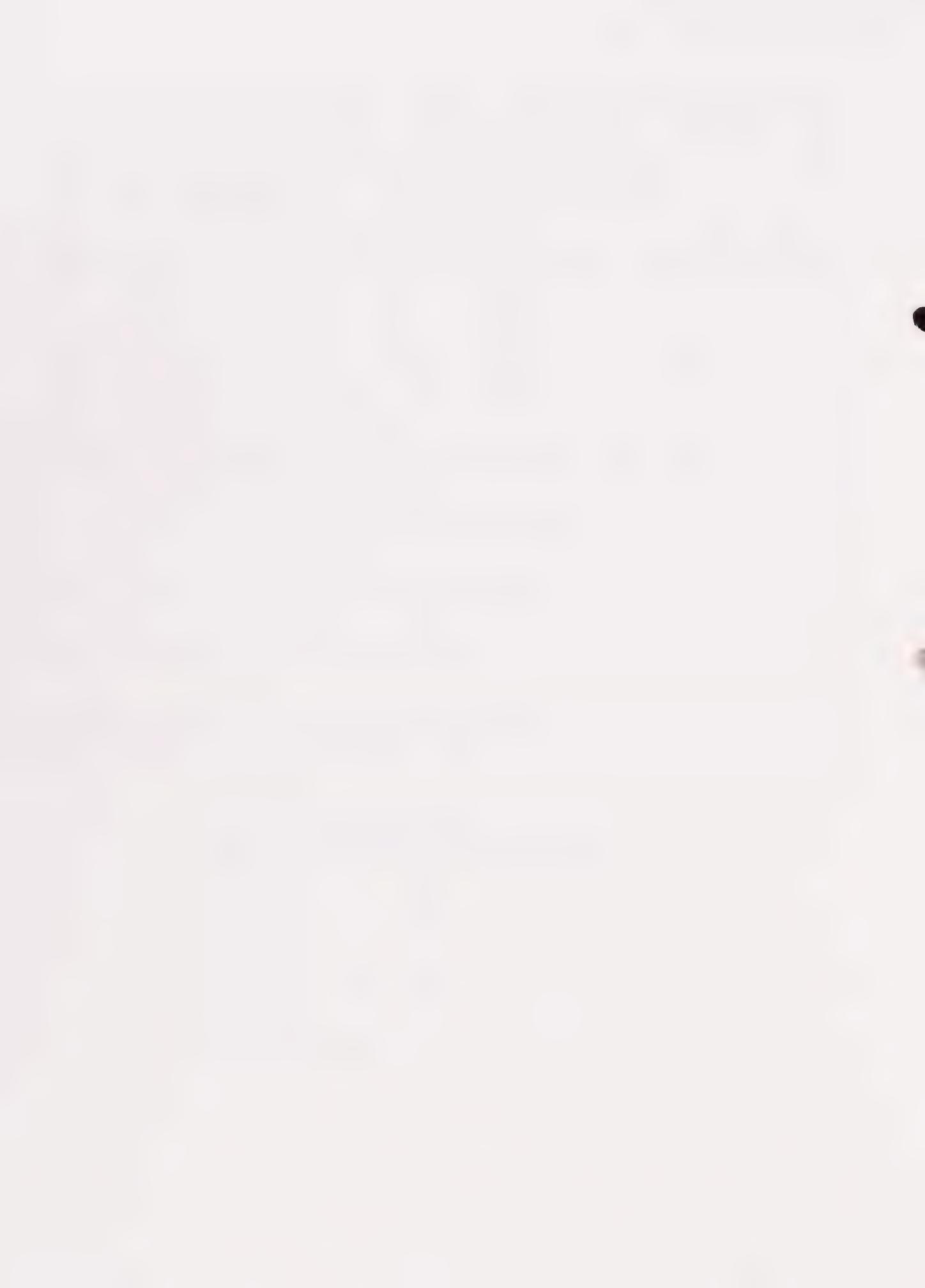
* 787 (13%) of 6,193 PO's issued in fiscal year 92-93 were outstanding for more than 6 months as of December 31, 1993.

** 405 (6%) of 7,263 PO's issued in fiscal year 91-92 were still outstanding for more than 18 months as of December 31, 1993.

In addition, 445 PO's issued prior to June 30, 1991 were still open as of December 31, 1993.

We judgmentally selected 38 Purchase Orders to determine their status and evaluate the reasons why they remain outstanding. The breakdown of the sample of 38 is as follows:

COUNT	FY ISSUED	AMOUNT
1	88	\$ 873
4	89	18,763
7	90	34,036
3	91	20,686
11	92	166,083
12	93	123,837
38		\$364,278



Departments selected included General Services, Transportation, Recreation and Parks, Municipal Auditorium, Mayor, Police, and Public Works. Our test showed:

1. Twenty (53%) PO's amounting to \$134,873 were no longer needed according to the department. Departments promised to cancel the PO's. As of January 31, 1994, the PO's were not canceled.
2. Five (13%) PO's amounting to \$78,819 were not needed according to the department. Those were canceled and verified as of January 31, 1994.
3. Eight (21%) PO's amounting to \$95,406 were still needed according to the requisitioning department. These PO's were either partially delivered or serviced, or not yet delivered.
4. Five (13%) PO's amounting to \$55,180 were delivered but no invoices were received. Payment was not made as of January 31, 1994.

Twenty-five (66%) of the 38 sampled PO's remained encumbered even though goods were no longer needed by the departments. Departments could have acquired the goods through other PO's. Goods reportedly needed for operations were not delivered within six months for eight (21%) of the PO's. Delays in obtaining needed supplies could, if extended over time, lead to an inability of line operations to function efficiently.

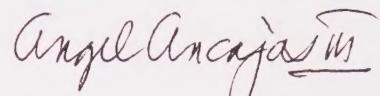
The Purchasing Division did not regularly monitor delivery of goods and did not know if a vendor delivered unless the requisitioning department advised the Purchasing Division for follow-up. "Due Delivery Date" was indicated on all PO's and contracts. However, there was no penalty clause included in case of past due delivery.

RECOMMENDATION

- Develop a system for monitoring open PO's with the objective of tracking down late delivery by vendors.
- Coordinate with the Controller's Office and analyze the "Purchase Order Overdue Notice Report."
- Coordinate with user departments to evaluate on-time delivery performance of vendors and show in vendor's performance rating.
- Work with Departments to identify past-due delivery items and encourage cancellation of these Purchase Orders.

The results of our audit were discussed with the General Services Department's Assistant General Managers, the Director of Supplies, and a Senior Management Analyst in charge of MMS at an exit conference held on October 19, 1994.

Respectfully submitted,



Angel Ancajas III
Auditor

April 30, 1994

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